



Agenda Item 7: Leases

João Fonseca

Manager, Standards Development and Technical Projects

IPSASB Meeting

June 21-24, 2016

Toronto, Canada

Objective of Session & Material Presented

- Agenda Item 7.1—Project Brief, *Leases*
- Agenda Item 7.2—Lessee—Applicability of IFRS 16 recognition and measurement requirements to public sector financial reporting
- Agenda Item 7.3—Lessee—“*Peppercorn*” leases
- Agenda Item 7.4—Lessor—Applicability of IFRS 16 recognition requirements to public sector financial reporting
- Agenda Item 7.5—Project Brief, *Leases* (marked-up version from March 2016 meeting)

Project Brief, *Leases* (Agenda Item 7.1)

- **Main amendments from March 2016 meeting**
 - Objective of the Leases project: issuance of a new IPSAS
 - Introduction of options in *Key Issue #4*—Sale and leaseback transactions
 - Introduction of *Key Issue #6*—Lack of symmetry in lease accounting
 - Introduction of *Key Issue #7*—“Peppercorn” leases
 - Government Finance Statistics update on leases
 - Project timetable

Project Brief, *Leases* (Agenda Item 7.1)

- **Sale and leaseback transactions (*Key Issue #4*)**
 - **IFRS 16**
 - **Sale?**
 - **Yes**, if it satisfies the performance obligation in IFRS 15
 - **No**, if it does not satisfy the performance obligation in IFRS 15
 - **IASB's view:**
 - This requirement “will be beneficial for both preparers and users of financial statements because it will increase comparability between sales entered into as part of a sale and leaseback transactions and all other sales.”
 - **IPSAS 9**  *Risks and rewards of ownership* approach
 - **IPSAS 23**  *Present obligation* approach

Project Brief, *Leases* (Agenda Item 7.1)

- **Sale and leaseback transactions (*Key Issue #4*)**

Step 1

Option 1

Do not include any requirement now
(current situation in IPSAS 13)

Option 2

Include requirements based on
current IPSASs (IPSAS 9 and 23)

Step 2

Include the performance obligation
approach later (consequential
amendment of the new IPSAS on
Revenue)

Project Brief, *Leases* (Agenda Item 7.1)

- **Lack of symmetry in lease accounting (*Key Issue #6*)**
Compatibility (?) between two models for the same transaction in public sector financial reporting

	Lessee	Lessor
Accounting Model	Right-of-use model	Risks and rewards incidental to ownership
Identification and Classification	1. Identification <ul style="list-style-type: none"> • Service versus Lease 	1. Identification <ul style="list-style-type: none"> • Service versus Lease 2. Classification <ul style="list-style-type: none"> • Finance lease versus Operating lease

Project Brief, *Leases* (Agenda Item 7.1)

• Lack of symmetry in lease accounting (*Key Issue #6*)

Statement	Lessee	Lessor
Financial Position	Right-of-use asset for all leases over 12 months unless the underlying asset is of low value	Finance lease: <ul style="list-style-type: none"> • Net investment in the lease recognized • Underlying asset derecognized Operating lease: <ul style="list-style-type: none"> • Lease receivable is not recognized • Underlying asset recognized
Financial Performance	Expense: <ul style="list-style-type: none"> • Depreciation, impairment • Constant periodic rate of interest 	Revenue: Finance lease: <ul style="list-style-type: none"> • Constant periodic rate of return Operating lease: <ul style="list-style-type: none"> • Straight-line basis

Project Brief, *Leases* (Agenda Item 7.1)

- **“Peppercorn” leases (*Key Issue #7*)**
 - Reduced, nominal, or rent-free leases for the whole period of use of the underlying asset that does not involve a sale and leaseback transaction
 - IFRS 16 – Lease asset is initially measured at cost
- 
- Understatement of the lease asset
 - Failure to recognize the subsidy from the lessor to the lessee in the financial statements of the lessee and of the lessor

Project Brief, *Leases* (Agenda Item 7.1)

- **“Peppercorn” leases (*Key Issue #7*)**
 - Two mutually exclusive options:

Option 1	Option 2
Within the scope of the new IPSAS on Leases	Within the scope of IPSAS 23 or in IPSASB’s current projects on non-exchange expenses and revenue

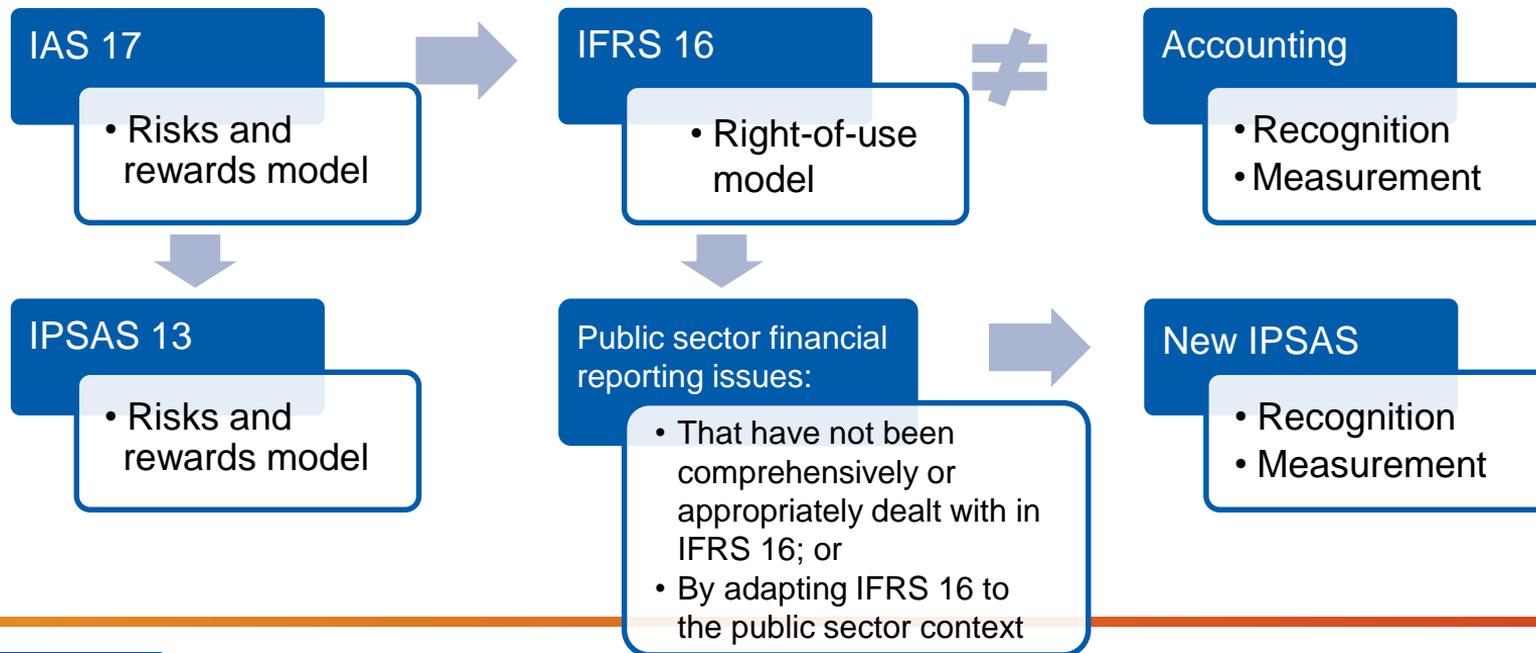
Project Brief, *Leases* (Agenda Item 7.1)

- **Indicative Project Timetable—Summary**

Meeting		Objective
2016	June	Approval of Project Brief
2017	March	Approval of Exposure Draft
2018	June	Approval of new IPSAS

Lessee (Agenda Item 7.2)

• Rules of the Road



Lessee (Agenda Item 7.2)

- **Rules of the Road —Step 1: Are there public sector issues that warrant departure?**

Element	Recognition	Measurement basis (initial measurement)
Asset	Right-of-use asset	Cost
Liability	Lease liability	Cost (reference to present value of the lease payments that are not paid at the commencement date)

Lessee (Agenda Item 7.2)

- **Criteria to assess IFRS 16 requirements**

- 1) Objectives of public sector financial reporting
- 2) Qualitative characteristics (QCs) of public sector financial reporting
- 3) Undue cost or effort
- 4) Consistency with other aspects of the *Conceptual Framework*
- 5) Internal consistency with existing IPSASs
- 6) Consistency with Government Finance Statistics (GFS)

Lessee (Agenda Item 7.2)

	Recognition		Measurement	
	Right-of-use Asset	Lease liability	Right-of-use Asset	Lease liability
Objectives	Reinforces		Impairs, unless fair value is used for “peppercorn” leases	Meets
QCs	Reinforces			
Undue effort or cost	No foreseen undue cost or effort.			
Conceptual Framework	Consistent		Consistent, but not appropriate	Consistent
IPSASs	No inconsistencies identified			
GFS	N/A			

Lessee (Agenda Item 7.2)

- **Staff's conclusions**

- Staff **did not identify** any public sector financial reporting reason that warrants departure from IFRS 16's **recognition** requirements on the applicability of the right-of-use model in lessee accounting
- The lessee accounting **recognition** requirements of the right-of-use model **better reflects the economics of a lease** than the previous model of risks and rewards incidental to ownership

Lessee (Agenda Item 7.2)

- **Staff's conclusions**

- The lessee **no longer** recognizes an underlying asset that it does not control, as in requirements in IPSAS 13 for finance leases;
- The lessee **always** recognizes an asset (the right-of-use asset), unlike in IPSAS 13 for operating leases;
- The lessee **always** recognizes the obligations resulting from the lease contract as liabilities, unlike in IPSAS 13 for operating leases;

Lessee (Agenda Item 7.2)

- **Staff's conclusions**

- The right-of-use model **prevents** arbitrage, gaming and information asymmetry, and improves comparability between public sector entities that lease assets and public sector entities that purchase assets.

Lessee (Agenda Item 7.2)

- **Optional Recognition Exemptions in IFRS 16**

- Short-term leases (lease term of 12 months or less)
- Leases for which the underlying asset is of low value (absolute basis)

- **Staff's conclusion**

- Staff **did not identify** a public sector financial reporting reason that would warrant different recognition exemptions from IFRS 16.

Lessee (Agenda Item 7.2)

• Require *versus* Permit recognition exemptions

Advantages	Disadvantages
<ul style="list-style-type: none">• Increased comparability between public sector entities• Increased cost relief in the application of the new IPSAS on Leases• It is still within the <i>Rules of the Road</i>	<ul style="list-style-type: none">• Divergence with IFRS 16• In low value leases that last a number of years may impact negatively reliability and accuracy of financial statements

- **Note:** 1. Does not impair comparability with private sector entities
2. Entities with a "mixed group" can adopt same accounting policy regarding recognition exemptions

Lessee (Agenda Item 7.2)

- **Rules of the Road**

- ***Step 2: Should a separate public sector project be initiated?***
 - Staff **did not identify** a persuasive case for initiating a public sector specific project on recognition exemptions and measurement of leases.
- **Step 3: Modify IASB documents**
 - Elimination of the option on recognition exemptions is covered by paragraph iii) of Step 3

Lessee (Agenda Item 7.2)

- **Does the IPSASB agree with staff's recommendation to:**
 - **Adopt** the recognition requirements of the IFRS 16's right-of-use model in lessee accounting in the new IPSAS on Leases
 - **Consider** whether recognition exemptions should be a requirement or an option in the new IPSAS on Leases

Lessee—“Peppercorn” leases (Agenda Item 7.3)

- **Two options:**

Option 1	Option 2
Within the scope of the new IPSAS on Leases	Within the scope of IPSAS 23 or in IPSASB’s current projects on non-exchange expenses and revenue

Lessee—“Peppercorn” leases (Agenda Item 7.3)

Criteria	Option 1	Option 2
Exchange transaction vs Non-exchange transaction	A “peppercorn” lease is still a lease	A “peppercorn” lease is in substance a grant or donation
Sector neutral vs sector specific approach to the definition of a lease	The definition of a lease should reflect a more neutral approach to lease accounting in the public sector	The new IPSAS on Leases should only address leases that are exchange transactions
Explicit requirements vs professional judgement	IPSASs should explicitly address transactions that are typical in the public sector and in international organizations	Use the principles in IPSAS 23 for professional judgement
Concentration vs dispersion of subject in IPSASs	Include all leases in the new IPSAS on Leases and the subsidized component in IPSAS 23	IPSAS 23 guidance can be applicable to “peppercorn” leases

Lessee—“Peppercorn” leases (Agenda Item 7.3)

- **Staff’s view:**

- The arguments in Option 1 outweigh those in Option 2 and recommends that the IPSASB proceeds with Option 1

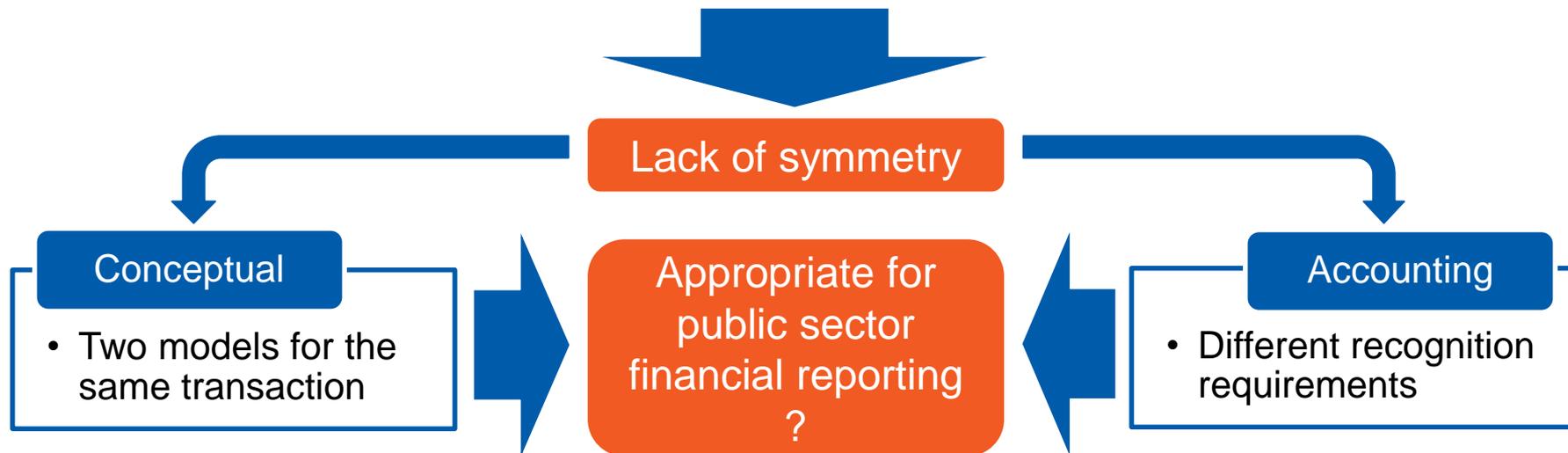
- **Does the IPSASB agree with staff’s recommendation to:**

- Address “peppercorn” leases in this project (Option 1); and
- Include specific requirements in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to address the non-exchange component of the lease (similar to concessionary loans)?

Lessor (Agenda Item 7.4)

• Rules of the Road

- IFRS 16, *Leases* **retains** the risks and rewards model of IAS 17;



Lessor (Agenda Item 7.4)

• Rules of the Road

- IFRS 16's lessor accounting **should be assessed** on whether it is **still applicable** to public sector financial reporting and **compatible** with the right-of-use model in lessee accounting;
 - **Positive answer**, then **no adaption** to public sector context is required;
 - **Negative answer**, then IFRS 16 **needs to be adapted** to the public sector context;

Lessor (Agenda Item 7.4)

- **Two-step approach**

- (a) Identify the requirements in IFRS 16 for lessor accounting that are not based on the right-of-use model;
- (b) Apply the *Rules of the Road* to the accounting requirements identified in (a)

Lessor (Agenda Item 7.4)

- **Rules of the Road—Step 1: Are there public sector issues that warrant departure?**

Element	Recognition	
	Finance Lease	Operating Lease
Asset	Derecognition of the underlying asset	Non-recognition of the lease receivable
Liability	Non-recognition of the unearned revenue (liability)	Non-recognition of the finance revenue

Lessor (Agenda Item 7.4)

- **Rules of the Road—Criteria to assess IFRS 16 requirements**
 - 1) Objectives of public sector financial reporting
 - 2) QCs of public sector financial reporting
 - 3) Undue cost or effort
 - 4) Consistency with other aspects of the *Conceptual Framework*
 - 5) Internal consistency with existing IPSASs
 - 6) Consistency with Government Finance Statistics (GFS)

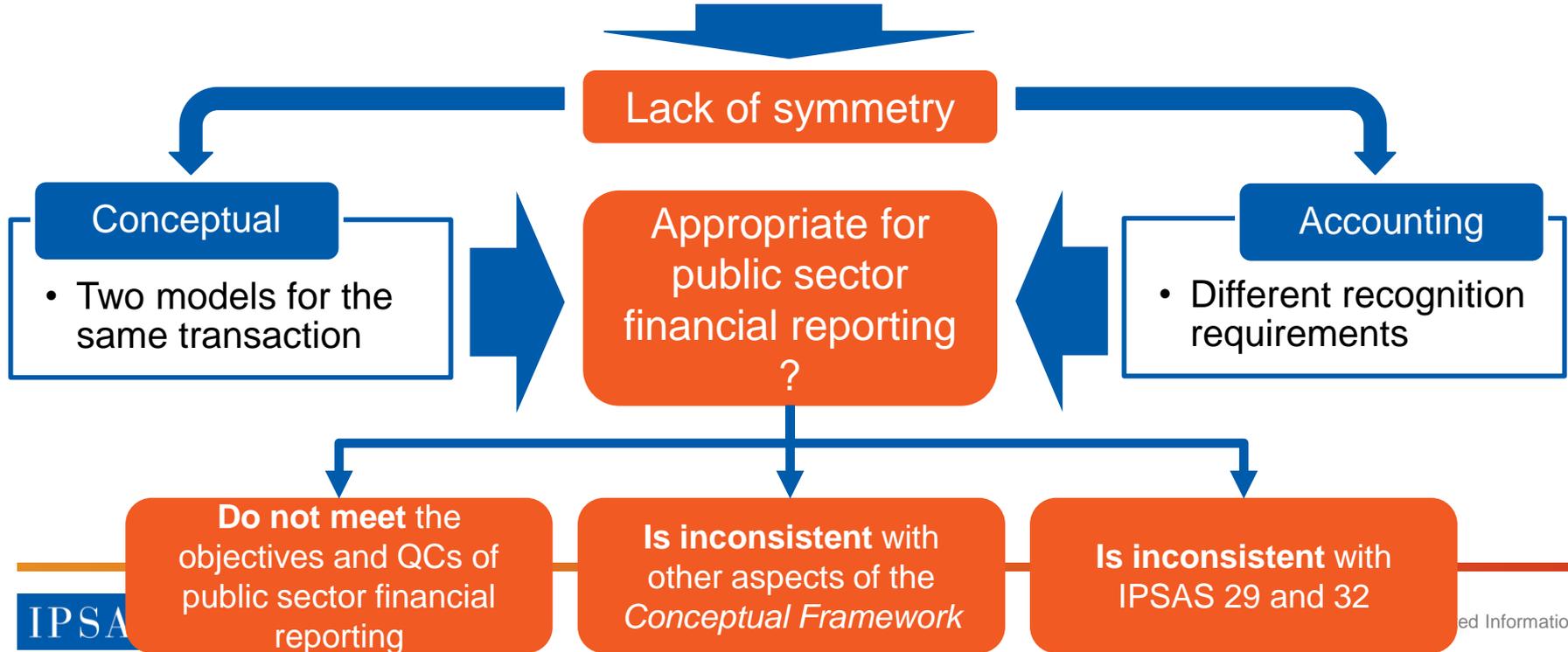
Lessor (Agenda Item 7.4)

	Finance Lease		Operating Lease	
	Derecognition of the underlying asset	Non-recognition of the unearned revenue (liability)	Non-recognition of the lease receivable	Non-recognition of the finance revenue
Objectives	Impairs			
QCs	Impairs			
Undue effort or cost	On-going consolidation issues with public sector entities depending on whether they are lessee or lessor Need to interpret two different models for the same transaction			
Conceptual Framework	Inconsistent	Decided at standards level	Inconsistent	
IPSASs	Inconsistent with IPSAS 32 (symmetry with IFRIC 12)		Inconsistent with IPSAS 29 (leases are in substance financing transactions)	
GFS	N/A			

Lessor (Agenda Item 7.4)

Staff's conclusion

Risks and rewards model



Lessor (Agenda Item 7.4)

- **IASB's rationale for retaining the dual model in lessor accounting**
 - “The lessor accounting model in IAS 17 is well understood”;
 - “Most users of financial statements do not currently adjust lessors' financial statements for the effects of leases”;
 - “Investors generally analyse the financial statements of individual entities (and not a lessee and lessor of the same underlying asset)”
 - “In contrast to lessee accounting, lessor accounting in IAS 17 is not fundamentally flawed and should not be changed solely because lessee accounting is changing”.

Lessor (Agenda Item 7.4)

- **IASB's rationale for retaining the dual model in lessor accounting**

- IASB's stakeholders **changed their views** on lessor accounting
 - Initially they supported changes to lessor accounting;
 - In the 2013 ED, they suggested that no changes should be made to lessor accounting for cost-benefit reasons.
- “In the light of this feedback, the IASB concluded that requiring a lessor to recognise a lease receivable for all leases would not improve financial reporting to the extent that the benefits from the improvements would outweigh the costs associated with that change.”

Lessor (Agenda Item 7.4)

- **Staff's comments on IFRS 16 lessor accounting (lack of symmetry)**
 - The reasons provided by the IASB's stakeholders:
 - **Are not related** to the economics of a lease nor to any identified fundamental or conceptual flaw in the application of recognition requirements of the right-of-use model to the lessor; and
 - **Are specific** to the business environment in which they operate and specific to users' needs in the for-profit sector.
 - The economic environment and users' needs in the for-profit sector **may be different** from the public sector. For example, it might be **difficult** for public sector stakeholders **to understand** different accounting principles for the same transaction.

Lessor (Agenda Item 7.4)

- Staff's comments on IFRS 16 lessor accounting (lack of symmetry)

Public Sector Issue	Description
Accountability	The public sector entity does not provide “information about the entity’s management of the resources entrusted to it for the delivery of services”.
Decision-making	<ul style="list-style-type: none"> • Users of the statement of financial position do not have information about the economic benefits embedded in the underlying asset from the cost, sale, re-lease or use of the underlying asset in finance leases. • Often public sector users do analyse the financial statements of lessee and lessor of the same underlying asset.
Lack of symmetry	Creates asymmetrical information in public sector financial reporting when governments do not publish consolidated financial statements.

Lessor (Agenda Item 7.4)

- Staff's comments on IFRS 16 lessor accounting (lack of symmetry)

Public Sector Issue	Description
Understandability	Increasing difficulty for public sector stakeholders to understand leasing arrangements with different accounting models for the same transaction.
Centralized lessors	Existence of centralized lessors in the public sector that manage assets of other public sector entities (under common control or not)
Frequency of lessees and lessors at the same time	Very often public sector entities: <ul style="list-style-type: none"> • Lease in and lease out the same underlying asset; • Are lessor and lessee in different lease contracts;

Lessor (Agenda Item 7.4)

- **Staff's comments on IFRS 16 lessor accounting (lack of symmetry)**
 - Example: National public sector accounting standard setter
 - Governmental Accounting Standards Board (GASB) published an Exposure Draft proposing the right-of-use model to be applicable to lessee and lessor (symmetry in lease accounting)
 - Reasons:
 - “governmental lessees and lessors should account for the same transaction in a way that mirrors how the other party accounts for it”;
 - “when the lessor and lessee are both part of the same reporting entity, symmetry in accounting prevents distortion of the total government’s financial position”.

Lessor (Agenda Item 7.4)

- **Costs and benefits of applying symmetry to lessor accounting**

Costs	Benefits
One-off implementation costs for lessors	Represents faithfully the economics of a lease
	Achieves the objectives of public sector financial reporting
On-going consolidation issues with commercial public sector entities that apply IFRS	Improves on-going consolidation of public sector entities that apply IPSASs
On-going costs of monitoring all leases in the balance-sheet	Better understanding of financing activities within the public sector and between the public sector and the private sector
	Improves comparability between public sector entities
	Increases simplicity and understandability of lease accounting
	Provides more transparent, relevant and verifiable information

Lessor (Agenda Item 7.4)

- **Does the IPSASB agree to adopt:**
 - The right-of-use model for lessor accounting, as the mirror accounting of IFRS 16 lessee's right-of-use model; or,
 - IFRS 16's lessor accounting model?



www.ipsasb.org

IFRS 16, IPSAS 32 and IFRIC 12

- Service versus Lease versus Service Concessions

Criteria	Service	Lease	Service Concessions
Control of an asset	Supplier: Yes Customer: No	Lessor: Yes Lessee: No	Grantor: Yes Operator: No
Control the use of an asset	Supplier: Yes Customer: No	Lessor: No Lessee: Yes	Grantor: Yes Operator: No
Access to operate an asset	Supplier: Yes Customer: No	Lessor: No Lessee: Yes	Grantor: No Operator: Yes

IFRS 16, IPSAS 32 and IFRIC 12

• Service versus Lease versus Service Concessions

Item of statement of financial position	Service	Lease	Service Concessions
Underlying asset	Supplier: Yes Customer: No	Lessor: Yes (op. lease) Lessee: No	Grantor: Yes Operator: No
Receivable (net investment in the lease)		Lessor: Yes (finance lease)	
Right-of-use asset		Lessor: No Lessee: Yes	
Financial asset/liability (unconditional right to receive/pay cash)			Grantor: Yes (L-FI) Operator: Yes (A-FI)
Intangible asset (right to charge users)			Grantor: Unearned revenue Operator: Yes