

Agenda Item 9: Leases

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IPSASB Meeting

Stellenbosch, South Africa

December 6–9, 2016

Material Presented for Decision at this Meeting

- **Decision Items:**

Agenda Item	Description
9.2.1	Lessor—Analysis of lessor accounting models and approaches
9.2.2	Lease—Measurement (including “peppercorn leases”)
9.2.3	Lessee—Reassessment of the lease liability and lease modifications
9.2.4	Sale and leaseback transactions—Draft section of core Standard and Basis for Conclusions

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1)

- Background

IPSASB September 2016 Meeting

IASB’s Exposure Drafts

Grant of a right to use model

Risks and benefits model (2010 ED)

Consumption of economic benefits model (2013 ED)

Leases are financings of the right to use an underlying asset

Lessor’s exposure to risks or benefits associated with the underlying asset:
 + Performance Obligation approach
 - Derecognition approach

Lessee’s consumption of economic benefits embedded in the underlying asset and its nature:
 + Type A (most leases of assets other than property)
 - Type B (most leases of property)



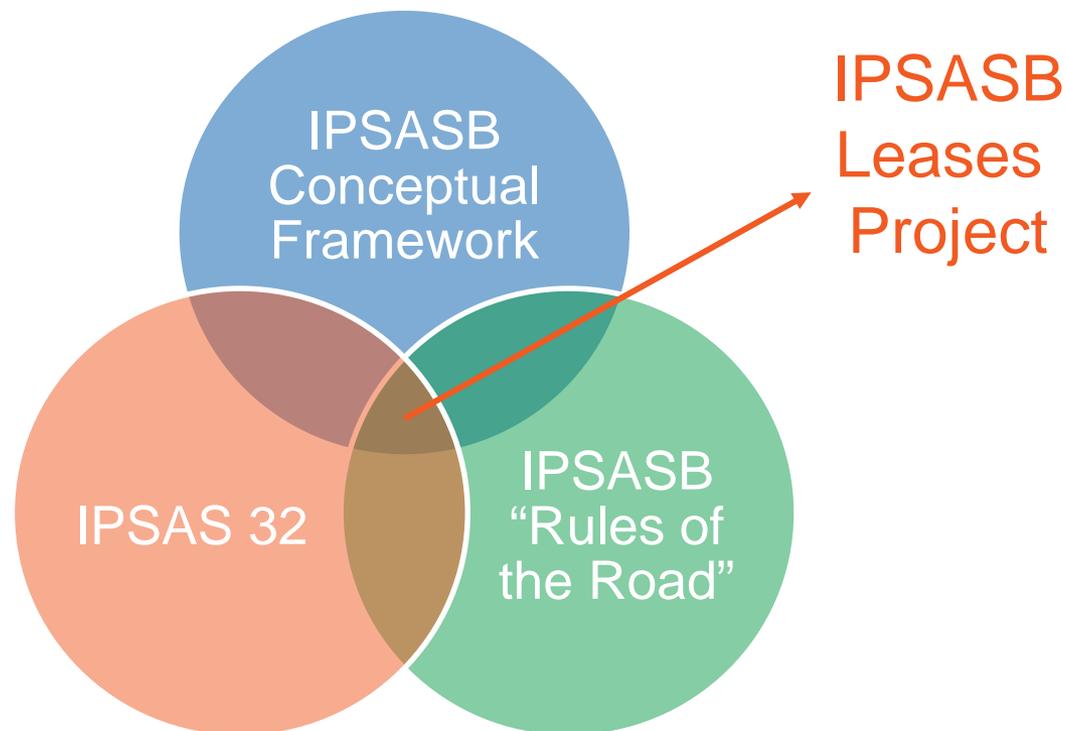
Single Model

Dual Models

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1)

- **Background**

Methodology of Analysis—Boundaries



Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1)

- **Background**

Criteria of Analysis of IASB's models



Conclusion:

IASB's models
are not
consistent
with lessee
accounting

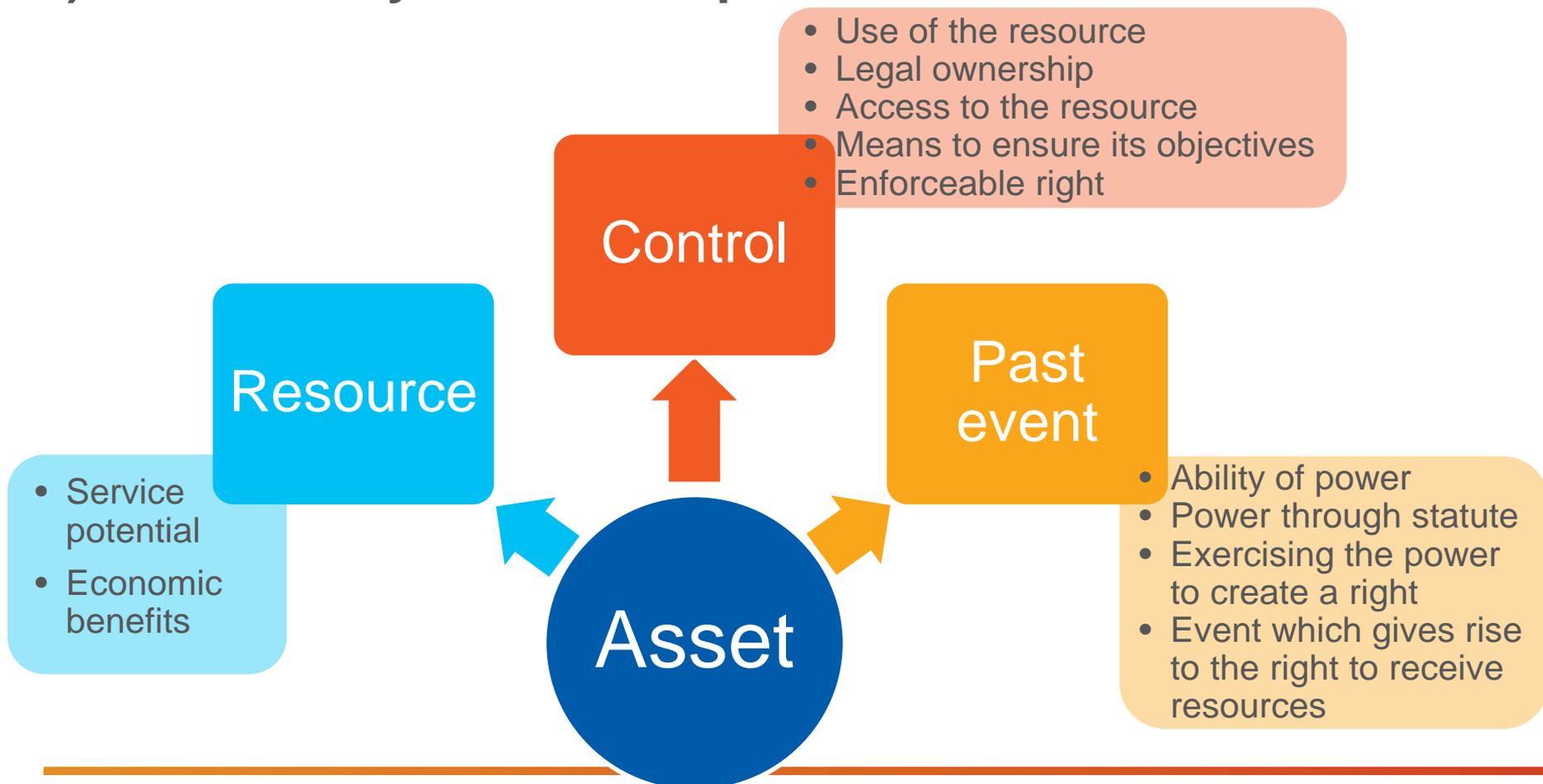
Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

Two mutually exclusive approaches to the right-of-use model

Items	Approach 1	Approach 2
Statement of financial position (initial recognition)		
Underlying asset	Continues to recognize the underlying asset in its entirety	<ul style="list-style-type: none"> • Derecognizes a portion of the underlying asset • Reclassifies as a residual asset the remaining portion of the underlying asset
Lease receivable	Recognizes a lease receivable	
Liability (unearned revenue)	Yes	No
Statement of financial performance		
Revenue	Interest revenue on the right to receive lease payments	
	<ul style="list-style-type: none"> • Lease revenue as the liability is satisfied 	<ul style="list-style-type: none"> • Lease revenue representing the present value of the lease payments
Expense	<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • Lease expense representing the cost of the portion of the underlying asset that is derecognized at the date of commencement of the lease

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework



Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework

Recognition

- An item satisfies the definition of an element; and
- Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

Derecognition

- Existence uncertainty
- Measurement uncertainty
- No more service potential or economic benefits
- Transfer of control

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework

Items	Approach 1	Approach 2
Underlying asset		
Historical cost	<ul style="list-style-type: none"> • A lease does not negate the historical cost of the underlying asset • Economic benefits included in the cost of the purchase and in the cost of the lease are different: <ul style="list-style-type: none"> ➤ Different economic natures ➤ Different confirmatory or predictive values • Provides: <ul style="list-style-type: none"> ➤ Financial capacity information ➤ Operational capacity information 	<ul style="list-style-type: none"> • Historical cost overstates the assets because the same economic benefit is represented twice in the statement of financial position: as a part of the historical cost of the asset, and as a lease receivable at the same time. • The statement of financial position should only recognize an asset for the amount to the rights retained in the underlying asset.

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework

Items	Approach 1	Approach 2
Underlying asset		
Measurement vs partial derecognition	<ul style="list-style-type: none"> A measurement approach to the underlying asset does not imply the recognition of a separate residual asset representing the rights retained in the underlying asset. A measurement approach may affect depreciation and impairment of the underlying asset. 	<ul style="list-style-type: none"> The lessor should derecognize the portion of rights in the underlying asset that were transferred to the lessee. The lessor should recognize only the rights retained in the underlying asset, as the lessee only recognizes the individual rights controlled in the right-of-use asset.
Physical assets as a whole versus a bundle of rights	<ul style="list-style-type: none"> Physical assets are recognized as a whole, and not as a bundle of rights. Physical assets cannot be transformed into “slices” of rights. 	<ul style="list-style-type: none"> Physical assets are recognized as a bundle of rights that can be sold individually. Physical assets can be transformed into “slices” of rights.

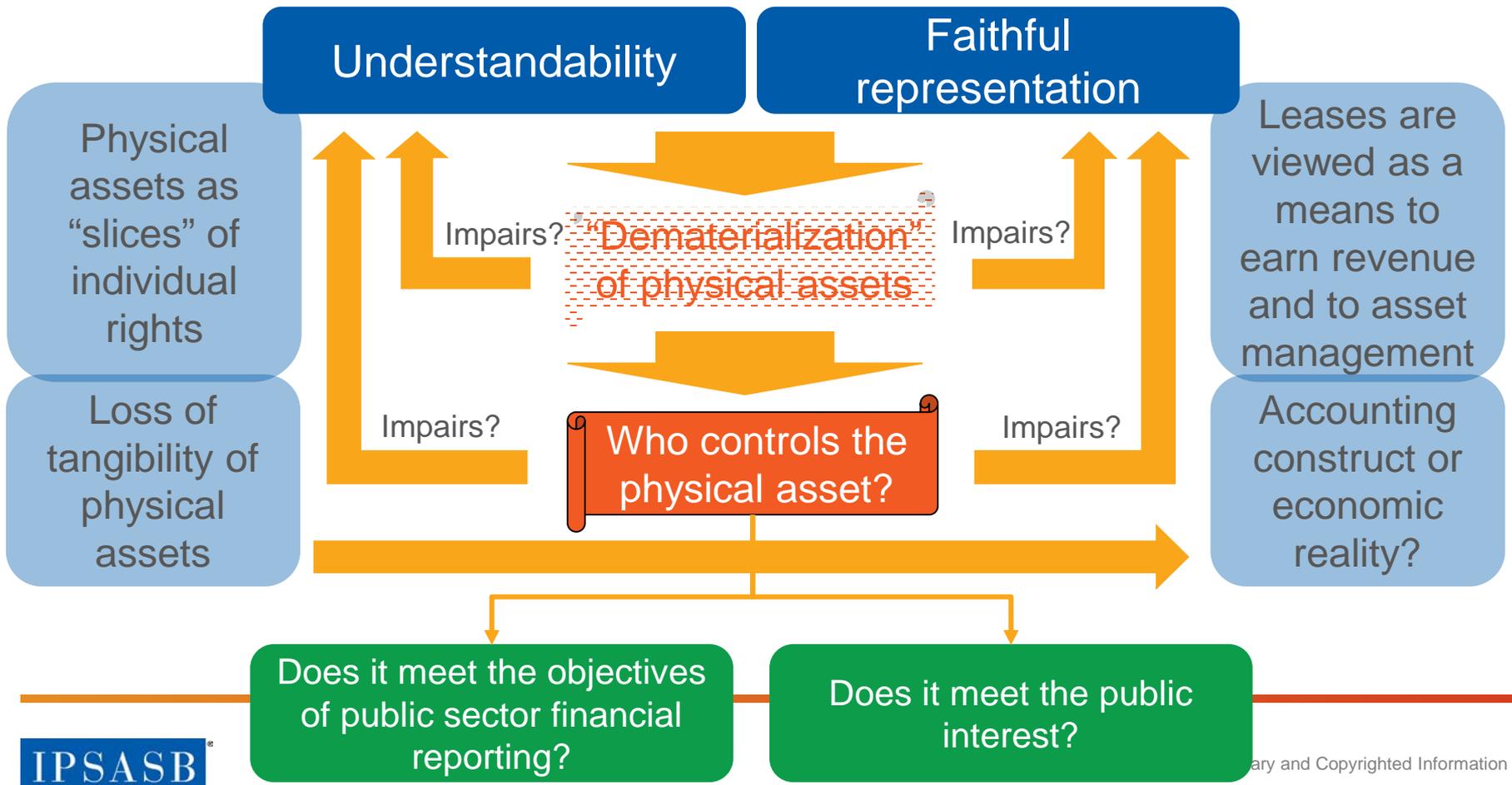
Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework

Items	Approach 1	Approach 2
Underlying asset		
Liability versus not a liability related to unearned revenue	<ul style="list-style-type: none"> • The grantor/lessor has a performance obligation to provide the operator with access to the underlying asset during the service concession/lease term. • This performance obligation can be considered as a present obligation because if the grantor/lessor does not provide the operator/lessee with access to the underlying asset, then it would need to derecognize the portion of the lease receivable that it would no longer earn. • This derecognition could be considered as an outflow of future economic benefits from the lessor to the lessee for the period when it does not provide access. 	<ul style="list-style-type: none"> • There would appear to be no expected outflow of future economic benefits from the lessor, which is an essential component of the definition of a liability.

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

2) Public sector specific issues and public interest considerations on Approach 2



Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

1) Consistency with Conceptual Framework

- **Matter for consideration**

1) How does the Conceptual Framework depict physical assets?

(a) In its entirety (Approach 1)

(b) As portions (rights) (Approach 2)

2) What is the economic nature of the credit entry?

(a) Liability (unearned revenue) (Approach 1)

(b) Revenue* (Approach 2)

(c) Other

* Balanced by a lease expense related to the derecognition of the portion of the underlying asset

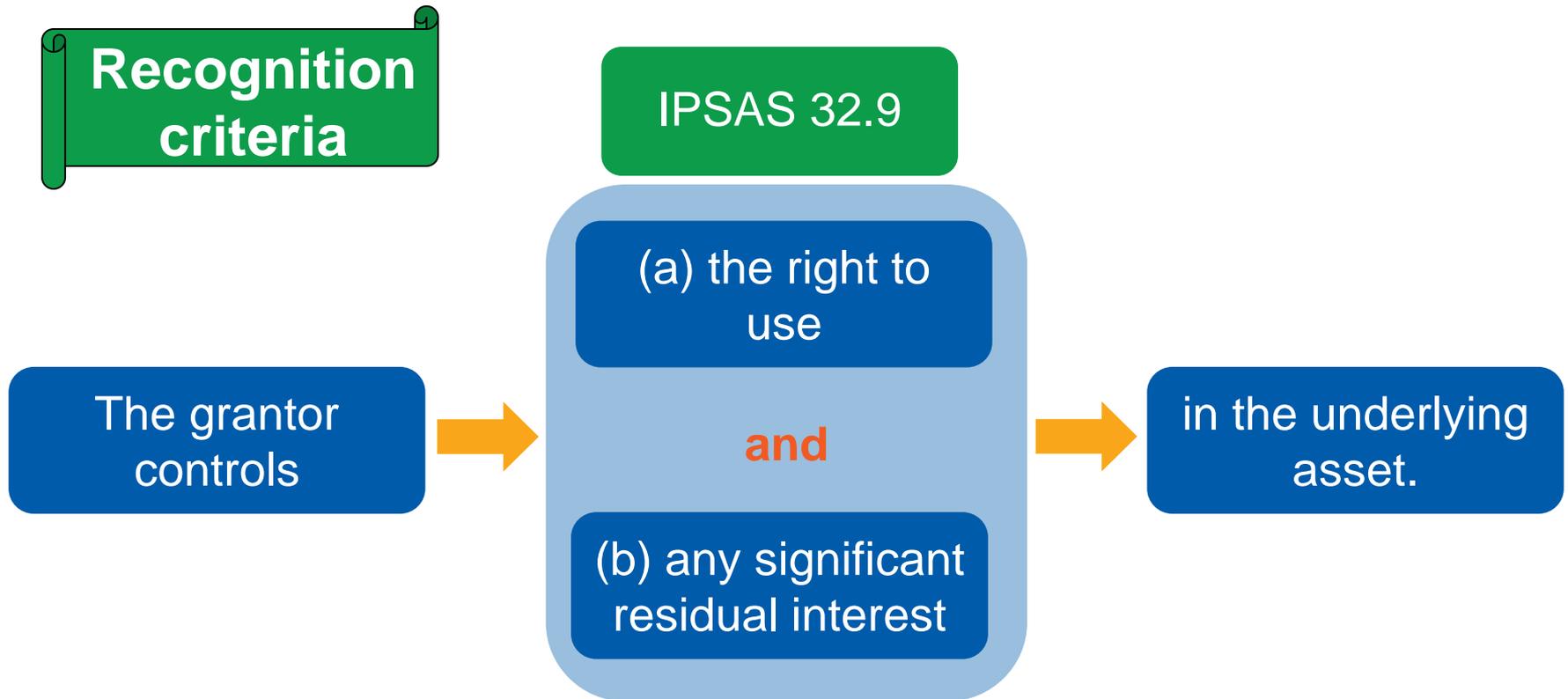
Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- Granting rights to use the underlying asset (right to access/operate)
- Mirror of IFRIC 12, *Service Concession Arrangements*
- Follows a control based approach to identify the underlying asset

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

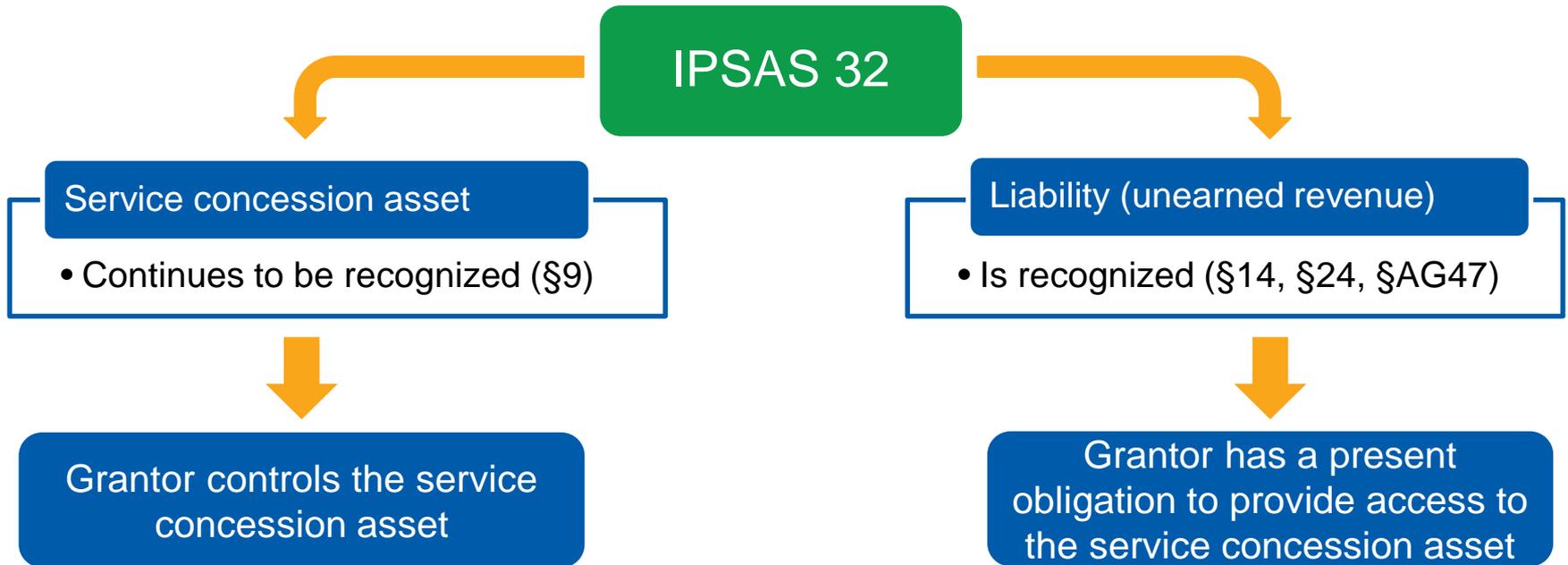
3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*



Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- Grant of a right to the operator model with existing asset (right to charge users—**operator bears the demand risk**)



Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- Discussion

Items	Approach 1	Approach 2
Underlying asset		
IPSAS 32.9(a) and 32.9(b)	Existence and transfer of control —Both subparagraphs need to be taken together .	<ul style="list-style-type: none"> Grantor retains control of the use Lessor transfers the right to use an underlying asset.
IPSAS 32.9(b)	Is applied to leases where the lessor controls —through ownership, beneficial entitlement or otherwise— any significant residual interest in the asset at the end of the term of the arrangement.	A lessor does not necessarily retains significant residual interest throughout the period of the arrangement.
Role of the operator / lessee	<ul style="list-style-type: none"> Service concession—The operator bears the demand risk and recognizes an intangible asset. Lease—The lessee bears the demand risk and recognizes a right-of-use asset. 	<ul style="list-style-type: none"> The operator provides public services related to the service concession asset on behalf of the grantor. The lessee does not act on behalf of the lessor.

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- **Matter for consideration**

Are IPSAS 32.9 criteria to recognize/derecognize an underlying asset applicable to the right-of-use model in lessor accounting?

(a) Yes, both sub-paragraphs are taken together
(Approach 1)

(b) No, focus should be only sub-paragraph 9(a)
(Approach 2)

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- Discussion

Items	Approach 1	Approach 2
Liability (unearned revenue)		
Grantor/lessor obligations	<ul style="list-style-type: none"> The grantor/lessor has the obligation to provide the operator with access to the underlying asset. Any payments received from the lessee not earned in the accounting period should be recognized as a liability until the conditions for revenue recognition are met, just like in service concessions. If the lessor does not provide the operator with access to the underlying asset during the lease term, then it would need to derecognize the portion of the lease receivable that it would no longer earn. This derecognition could be considered as an outflow of future economic benefits from the lessor to the lessee for the period when it does not provide access. 	<p>An obligation to permit the lessee access to the underlying asset is not a liability because there would appear to be no expected outflow of future economic benefits from the lessor, which is an essential component of the definition of a liability.</p>

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

3) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*

- **Matter for consideration**

Is IPSAS 32.24 criterion to recognize a liability (unearned revenue) applicable to the right-of-use model in lessor accounting?

(a) Yes (Approach 1)

(b) No (Approach 2)

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

4) Consistency with lessee accounting

Lessee	Lessor
<ul style="list-style-type: none">• Right-of-use asset• Lease liability	<ul style="list-style-type: none">• Approach 1<ul style="list-style-type: none">• Underlying asset (entirety)• Lease liability (unearned revenue)• Approach 2<ul style="list-style-type: none">• Residual asset (rights)• Lease receivable

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1—Appendix B)

4) Consistency with lessee accounting

- **Matter for consideration**

Which approach to lessor accounting is more consistent with lessee accounting?

(a) Approach 1

(b) Approach 2

Lessor—Analysis of lessor accounting models and approaches (Agenda Item 9.2.1)

- **Matter for consideration**

Which approach to lessor accounting does the IPSASB want to adopt in the Exposure Draft on Leases?

(a) Approach 1?

(b) Approach 2?

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

- 1) Replace the term “peppercorn leases” with the term concessionary leases
- 2) Measurement basis of leases
- 3) Accounting of the subsidized component in concessionary leases

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

1) Replace the term “peppercorn leases” with the term **concessionary leases**

Reasons for change:

- Translation to other languages
- IPSAS 23 and 29 apply the term concessionary loan
- Meaning of concessionary lease might be broader than concessionary loan depending on the definition of a lease:



Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

1) Replace the term “peppercorn leases” with the term concessionary leases

- **Matter for consideration**

Does the IPSASB want to replace the term “peppercorn leases” with the term concessionary leases?

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

2) Measurement basis of leases

Reasons for change:

- IFRS 16, *Leases* measures leases at cost



Does not reflect the economics of a concessionary lease



Does not capture the subsidized component in a concessionary lease

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

2) Measurement basis of leases

- **Three Options:**

Option 1—Measure all leases at fair value regardless of whether they are concessionary;

Option 2—Measure leases that are exchange transactions at cost and measure concessionary leases (non-exchange transaction) at fair value; and

Option 3—Measure concessionary leases at cost and provide disclosures.

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

2) Measurement basis of leases

	Advantages	Disadvantages
Option 1	<ul style="list-style-type: none"> • Consistency—because all leases would have a single measurement basis; • Lessee’s lease liability and lessor’s lease receivable—Comparability with IPSAS 29 because of the similar measurement basis as other financial assets and financial liabilities. 	<ul style="list-style-type: none"> • Cost implications—because fair value would need to be determined for all leases; • Divergence with IFRS 16.
Option 2	<ul style="list-style-type: none"> • Consistent with IPSAS 17, <i>Property, Plant and Equipment</i> and IPSAS 31, <i>Intangible Assets</i> that distinguishes acquisitions through an exchange transaction from an non-exchange transaction; • Convergence with IFRS 16 for leases that are exchange transactions. 	<ul style="list-style-type: none"> • Finding the boundary between exchange and non-exchange may be difficult in practice in leases that are below market value, but have significant consideration.
Option 3	<ul style="list-style-type: none"> • Addresses the difficulty about measuring the fair value of a concessionary lease. 	<ul style="list-style-type: none"> • Disclosures are not a substitute for recognition of an element (subsidized component).

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

2) Measurement basis of leases

- **Matter for consideration**

Does the IPSASB want to choose:

(a) Option 1

(b) Option 2

(c) Option 3

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

Three options:

Option 1—Apply guidance in IPSAS 23 and IPSAS 29 to concessionary loans;

Option 2—Deferred expense for lessor accounting; and

Option 3—Impairment trigger of the underlying asset.
This option can work with option 1 or 2.

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

Option 1—IPSAS 23 and IPSAS 29—Concessionary loans

Accounting of the subsidized component

Transferor	Recipient
<ul style="list-style-type: none">• Expense• Except, if it is a transaction with owners	<ul style="list-style-type: none">• Revenue• Except, if there is a present obligation

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

Option 2—Deferred expense for lessor accounting (IPSAS 29.AG82)

Transferor	Recipient
<ul style="list-style-type: none">• Expense• “Unless, it qualifies for recognition as some other type of asset”.	<ul style="list-style-type: none">• Revenue• Except, if there is a present obligation

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

Option 2—Deferred expense for lessor accounting (IPSAS 29.AG82)

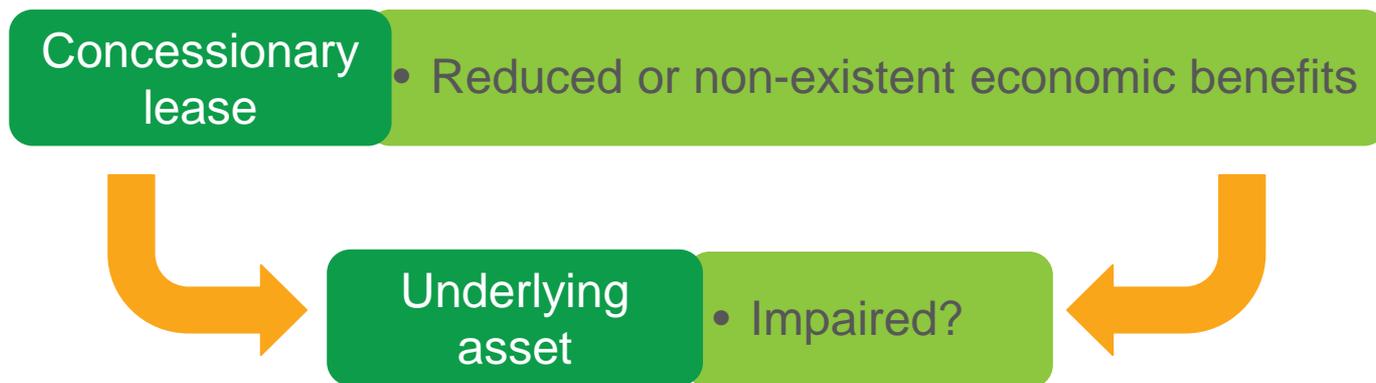
Staff’s comments:

- (a) IPSAS 29.AG82 is applicable, for example, to credit impaired loans at its origination, and not to concessionary loans. For example, the creditworthiness of a financial instrument is below its transaction price. The section on concessionary loans starts at IPSAS 29.AG84;
- (b) IPSAS 29.AG82 is applicable to other types of assets specified in the Standards. This means that in the context of concessionary loans there is an asset if it is considered as a capital contribution from owners (see IPSAS 29.AG89(b)); and
- (c) The Conceptual Framework does not identify deferred expenses as elements.

Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

Option 3—Impairment trigger of the underlying asset



Lease—Measurement (including “peppercorn leases”) (Agenda Item 9.2.2)

3) Accounting of the subsidized component in concessionary leases

- **Matter for consideration**

Does the IPSASB want to choose:

(a) Option 1

(b) Option 2

(c) Option 3

Lessee—Reassessment of the lease liability, lease modifications and lease term (Agenda Item 9.2.3)

Appendix A – Draft Exposure Draft sections (Marked-up from IFRS 16, *Leases*)

- **Matter for consideration**

Does the IPSASB want to adopt the IFRS 16 requirements on:

- (a) Reassessment of the lease liability, lease modifications and separating components of a contract from the lessee side?
- (b) Lease term?

Sale and leaseback transactions (Agenda Item 9.2.4)

Appendix A – Draft Exposure Draft section (Marked-up from IFRS 16, *Leases*)

- **Matter for consideration**

Does the IPSASB agree with the draft section on sale and leaseback transactions in the Exposure Draft on Leases, including the Basis for Conclusions?



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