

Agenda Item 7: Leases

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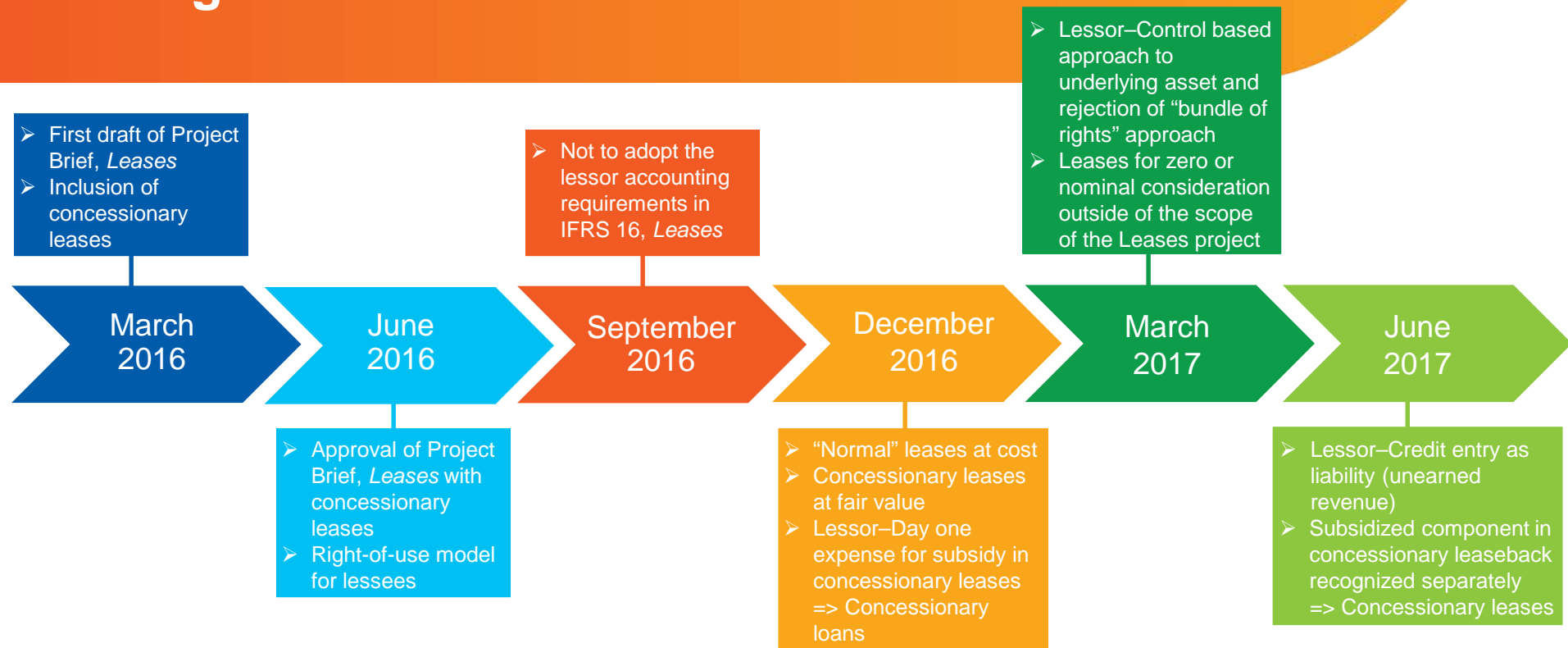
Objective of Session & Material Presented

- Agenda Item 7.2.1—“Double-Counting” versus “Gross” versus “Offset”/”Net”
- Agenda Item 7.2.2—Lessor—Measurement of the Underlying Asset
- Agenda Item 7.2.3—Concessionary Leases—Measurement
- Agenda Item 7.2.4—Presentation and Disclosures
- Agenda Item 7.2.5—Amendments to Other IPSASs
- Agenda Item 7.2.6—Lessor—Credit Entry (Liability—Unearned Revenue) Related to Subsidy in Concessionary Leases (addendum)
- Agenda Item 7.2.7—Transitional Provisions

Objective of Session & Material Presented

- Agenda Item 7.2.8—Approval of draft Exposure Draft (ED) 64, *Leases and Exposure Period*
- Agenda Item 7.3—Draft Exposure Draft, *Leases*

Background



“Double-Counting” versus “Gross” versus “Offset”/“Net” (Agenda Item 7.2.1)

- **Meaning of “Double-Counting”, “Gross”, and “Offset”/“Net”**
 - Double-counting in accounting is where a single transaction (economic phenomenon) is recognized or counted more than once.
 - Double-counting is an accounting error.
 - IPSASB’s literature: IPSAS 16.59, IPSAS 26.56.
- **Meaning of “Gross” and “Offset”/“Net”**
 - Unlike double-counting, “gross” and “offset”/“net” related to presentation of elements in the financial statements, and do not give rise to accounting errors.
 - Principle in IPSAS 1.48 “no offsetting”, unless required or permitted by an IPSAS.

“Double-Counting” versus “Gross” versus “Offset”/”Net” (Agenda Item 7.2.1)

- **Staff’s view**

- “Double-counting” and “gross” should not be used interchangeably because of their different meaning.

- **Matter for consideration**

- Does the IPSASB agree with staff’s view that “double-counting” and “gross” should not be used interchangeably in IPSASB’s literature?

“Double-Counting” versus “Gross” versus “Offset”/“Net” (Agenda Item 7.2.1)

- **Is double-counting resolved by offsetting/netting?**
 - Some could argue that double-counting is resolved by offsetting because the transaction(s) would be presented on a net basis.
- **Staff’s view**
 - Double-counting is not resolved in IPSAS by offsetting one transaction against another transaction or one element against another.
 - Double-counting is only resolved in IPSAS by not repeating the accounting of the same transaction more than once.

“Double-Counting” versus “Gross” versus “Offset”/“Net” (Agenda Item 7.2.1)

- **Matter for consideration**

- Does the IPSASB agree with staff’s view that double-counting is not resolved by offsetting/netting?

Lessor—Measurement of the Underlying Asset (Agenda Item 7.2.2)

- **Draft ED 64 proposes:**

- To measure the underlying asset in accordance with IPSAS 16, IPSAS 17 or IPSAS 31, as appropriate.
- Paragraphs in the Basis for Conclusions explaining that:
 - There is no double-counting under the cost model (paragraph BC54(a));
 - There is no need to replicate IPSAS 16 requirements to avoid double-counting under fair value model in draft ED 64 (paragraph BC54(b)); and
 - Offsetting in lessor accounting is inappropriate because of the different economic natures of the underlying asset, the lease receivable and the liability (unearned revenue) (paragraphs BC56–BC60). The lease receivable is balanced by the liability (unearned revenue) with no impact on net financial position.

Lessor—Measurement of the Underlying Asset (Agenda Item 7.2.2)

- **Matter for consideration**
 - Does the IPSASB agree with the staff proposal on measurement of the underlying asset in draft ED 64?

Concessionary Leases—Measurement (Agenda Item 7.2.3)

- **Background**

- June 2017 meeting – IPSASB's decision
 - Not to include in the scope section of the ED the reference to scoping out leases for zero or nominal consideration in order to ensure consistency with IPSASB's ED 62 to update IPSAS 28-30 related to grants in concessionary loans; and
 - Remove from draft ED 64 the paragraphs on measurement of concessionary leases at fair value because they need to be reassessed for consistency with previous IPSASB decisions.
- Suggestion to include additional guidance and illustrative examples on how to account for concessionary leases under the recognition exemptions.

Concessionary Leases—Measurement (Agenda Item 7.2.3)

I—Concessionary Leases—General Guidance

- Measure the lease liability for lessees and the lease receivable for lessors at fair value using a market interest rate to discount the lease payments:
 - Avoids **overvaluing** the lease liability/receivable in the statement of financial position in the cases where the market interest rate is higher than the contractual rate ➔ **Consistent** with IPSAS 29;
 - Avoids **undervaluing** the interest revenue/expense of the lease in the statement of financial performance ➔ **Consistent** with IPSAS 29; and
 - For lessee's, using the incremental borrowing rate does not work in the situations where the lessee obtains funds in a **different economic environment** (for example: in a concession environment).

Concessionary Leases—Measurement (Agenda Item 7.2.3)

I—Concessionary Leases—General Guidance

- **Staff's recommendation**
 - Measure the contractual lease payments using market interest rates.
- **Matter for consideration**
 - Does the IPSASB agree with the staff's recommendation to use market interest rates to discount the contractual lease payments?

Concessionary Leases—Measurement (Agenda Item 7.2.3)

II—Concessionary Leases—Recognition Exemptions

- **Different from general guidance**
 - The subsidized component is included in the cost of the lease and, therefore, it is not separately recognized.
- **Reasons for different guidance**
 - Related to the recognition exemptions in lease accounting.

Concessionary Leases—Measurement (Agenda Item 7.2.3)

II—Concessionary Leases—Recognition Exemptions

Advantages	Disadvantages
Cost benefit —Separate accounting of the subsidized component outweighs its benefits in the same way as for the requirements in lease accounting.	By not accounting separately for the subsidized component, it can impair faithful representation and relevance, especially in short-term leases with high-value underlying assets.
Understandability —Proposed accounting is consistent with requirements in IPSAS 13, from which the accounting requirements for the recognition exemption are based.	It is not consistent with the requirements under the general guidance for concessionary leases.

Concessionary Leases—Measurement (Agenda Item 7.2.3)

II—Concessionary Leases—Recognition Exemptions

- **Staff's recommendation**
 - Adopt the exemptions for concessionary leases in the draft ED for cost-benefit reasons.
- **Matter for consideration**
 - Does the IPSASB agree with the staff's recommendation to adopt the exemptions for concessionary leases in the draft ED for cost-benefit reasons proposed in draft ED 64?

Presentation and Disclosures (Agenda Item 7.2.4)

- **Lessee accounting**
 - Based on IFRS 16.
 - Disclosures on concessionary leases based on IPSAS 30, *Financial Instruments: Disclosures* for concessionary loans.
- **Lessor accounting**
 - Presentation
 - Based on IFRS 16.
 - Symmetrical requirements in lessee accounting to the extent possible.

Presentation and Disclosures (Agenda Item 7.2.4)

- **Lessor accounting**

- Disclosures

- Based on IFRS 16 on requirements for finance and operating leases to the extent possible.
 - Symmetrical requirements in lessee accounting to the extent possible.
 - Disclosures on concessionary leases based on IPSAS 30 for concessionary loans.

Presentation and Disclosures (Agenda Item 7.2.4)

- **Matter for consideration**
 - Does the IPSASB agree with staff's approach to presentation and disclosures in draft ED 64?

Amendments to Other IPSAS (Agenda Item 7.2.5)

- **Two major types of amendments**
 - IFRS 16 related amendments to IPSAS that are drawn from IFRSs (identified in marked-up and struck through for IPSASB's information).
 - IPSAS specific amendments to IPSAS because of the IPSASB's decision to depart from IFRS 16 for lessor accounting and the specific guidance on concessionary leases (identified in double marked-up and double struck through for IPSASB's information).
 - Cash basis IPSAS also amended.
 - Full marked-up IPSAS 16, *Investment Property* to be published.

Amendments to Other IPSAS (Agenda Item 7.2.5)

- **Matter for consideration**
 - Does the IPSASB agree with staff's approach to amendments to other IPSASs in the draft Exposure Draft on Leases?

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

Loans*

Borrower

Cash	Loan
100	100

Lender

Cash	Loan
100	100

Credit entry:
Derecognition
of cash

Leases*

Lessee

Right-of-use asset	Lease liability
100	100

Lessor

Liability (unearned revenue)	Lease receivable
100	100

Credit entry:
Recognition of liability
(unearned revenue)

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

Concessionary Loans*

Borrower

Cash		Loan		Liability (unearned revenue)	
100			80		20

Lender

Cash		Loan		Expense (subsidy)	
100	100	80		20	

Credit entry:
Derecognition
of cash

Concessionary Leases*

Lessee

Right-of-use asset		Lease liability		Liability (unearned revenue)	
100			80		20

Lessor

Liability (unearned revenue)		Lease receivable		Expense (subsidy)	
	100	80		20	

Credit entry:
Recognition of liability
(unearned revenue)

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Conclusions**

- Loan accounting and lease accounting **are not comparable at credit entry**:
 - In loan accounting the credit entry gives rise to a **derecognition** of an asset (cash) → cash **is divisible** by nature; and
 - In lease accounting model adopted by the IPSASB the credit entry **does not give rise to the derecognition** of the underlying asset or portions of it → **indivisibility** of the (control of the) underlying asset.

Consistent with the IPSASB's previous decision and requirements in IPSASB's literature that an underlying asset should only be derecognized in its entirety on disposal or when no future economic benefits or service potential are expected from its disposal.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Conclusions**

- Loan accounting and lease accounting **are only comparable at debit entry:**
 - In both loan and lease accounting it is recognized a loan/lease receivable and an expense for the subsidized component (debit entry).

Consistent with IPSASB's decision that the lessor should recognize a day one expense for the subsidy granted because different accounting treatments for similar transactions potentially risk arbitrage.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **New key issue**
 - Whether recognizing a **liability (unearned revenue)** that is greater than the lease receivable is faithfully representative of that revenue and relevant to depictions of a lessor's financial performance and financial position.
- **New key issue not addressed in IPSASB's literature**
 - IPSAS 32, *Service Concession Arrangements: Grantor* and IPSAS 9, *Revenue from Exchange Transactions* only deal with exchange transactions; and
 - In dealing with concessionary loans in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement* the credit entry is the derecognition of cash transferred to the loan recipient

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Two Options for IPSASB's Decision**
 - Recognize the credit entry in **net assets/equity** (New variant of Option 1); or
 - Recognize concessionary leases for lessors **only at cost** (Option 5).

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Recognize the credit entry in **net assets/equity**
 - Rationale:
 - The credit entry can be viewed as the **total economic value created** when the lease contract is signed and is divided into two components:
 - **Exchange component** – Representing the economic value to be received as **future cash-flows** by the lessor → (Liability (unearned revenue))
 - **Non-exchange component** – Representing the economic value that the lessor **forgave** to lessee and recognized separately as expense → (Net assets/equity)

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Recognize the credit entry in **net assets/equity**
 - Advantages:
 - Avoids the mismatch between the timing of revenue and expense recognition that Option 1 implies;
 - Avoids labelling as revenue something that will never be effectively received that Option 2 implies;
 - Avoids reversal of previous IPSASB's decision to:
 - Include concessionary leases in the scope of the Leases project that Options 3 and 4 implies;
 - Measure lease at fair value that Option 5 implies;
 - Avoids requiring an impairment charge for all leases irrespective of the lease terms that Option 6 implies

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Recognize the credit entry in **net assets/equity**
 - Advantages:
 - It is consistent with previous IPSASB's decisions:
 - To recognize an expense for the subsidized component (consistent with IPSAS 29);
 - To recognize a liability (unearned revenue) for the exchange component (consistent with IPSAS 32 and IPSAS 9); and
 - In concessionary leasebacks.
 - Consistent with lessee accounting in the measurement of the concessionary lease.
 - Consistent with the accounting for remeasurements in IPSAS 39, *Employee Benefits*
 - ➔ (different economic nature)

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Recognize the credit entry in **net assets/equity**
 - Disadvantage:
 - New item in net assets/equity that will never be unwind

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Recognize concessionary leases for lessors **only at cost****
 - Rationale:
 - Do not provide guidance on the accounting for the subsidized component.
 - Reverse a previous IPSASB's decision to measure concessionary leases at fair value for lessors.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Recognize concessionary leases for lessors **only at cost**

Advantages	Disadvantages
<ul style="list-style-type: none">• Simple to understand.• Receive feedback from constituents.	<p>Inconsistent with the:</p> <ul style="list-style-type: none">a) Approach adopted for lessee accounting where the concession received is recognized as revenue separately from the right-of-use asset;b) Requirement in IPSAS 29 that a lender recognizes an expense on day one for the concessionary component of a concessionary loan; andc) Accrual basis of accounting more generally—the accounting for concessionary leases by lessors would be based only on cash-flows.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Staff's view**
 - **None of the options are optimal**
 - Recognizing the credit entry in **net assets/equity** avoids many of the disadvantages of other options identified, while it is consistent with previous IPSASB's decisions. But, the item will never be unwind.
 - Recognizing concessionary leases for lessors **only at cost** is a simpler option, but implies a reversal of IPSASB's decisions and inconsistency with lessee accounting and concessionary loan.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Draft BCs on Concessionary Leases (Option of net assets/equity)**

BC65. Additionally, as for lessors the subsidized component is recognized as expense in surplus or deficit at initial recognition, the IPSASB considered on how to account for the credit entry related to that same subsidized component.

BC66. The IPSASB decided that the credit entry related to the subsidized component should be recognized in net assets/equity because:

- (a) Of consistency with IPSAS 32, where the liability (unearned revenue) is only for the exchange component in the lease;
- (b) Of consistency with lessee accounting, where concessionary leases are measured at fair value;
- (c) It avoids labelling as revenue something that will never be effectively received from the lessee;
- (d) It avoids the mismatch between the timing of revenue and expense recognition if recognized as a liability (unearned revenue) for essentially the same subsidized component; and
- (e) It avoids requiring an impairment charge for all leases irrespective of the lease terms

BC68. [Deleted]

BC69. [Deleted]

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Matter for Consideration**
 - Which option does the IPSASB want to adopt in ED 64?
 - (a) Recognize the credit entry in **net assets/equity**; or
 - (b) Recognize concessionary leases for lessors **only at cost**.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Six options for IPSASB's information**

Option 1 – Continue with the approach in draft ED 64;

Option 2 – Treat the credit entry as revenue on day one;

Option 3 – Scope all concessionary leases out of ED 64 and consider accounting for concessionary leases in the Revenue and Non-Exchange Expense projects;

Option 4 – Scope concessionary leases for lessors out of ED 64 and consider lessor accounting for concessionary leases in the non-exchange expenses project;

Option 5 – Recognize concessionary leases for lessors only at cost i.e., the transaction price; and

Option 6 – Treat the subsidy expense as a trigger of impairment for the lessor's underlying asset and recognize an impairment expense on day one: Debit – Concessionary Expense / Credit – Asset Impairment.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 1 – Continue** with the approach in draft ED 64
 - Rationale 1:
 - The economic nature of the credit entry is **independent** of the debit entry (cash, receivable or grant). The accrual basis of accounting requires a credit entry to be made whether the debit is cash (received upfront), lease receivable (received over the term of the lease contract), or a grant (no/partial payment for the right-of-use asset). The credit entry in lessor accounting matches the right-of-use asset in lessee accounting.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 1 – Continue** with the approach in draft ED 64
 - Rationale 2:
 - The credit entry to liability (unearned revenue) (and the subsequent unwinding through lessor's revenue) reflects the granting back of the subsidized portion of the right-of-use asset from the lessee progressively over the lease term, resulting in the lessor recognizing income over that period.
 - In other words, the unwinding of the initial concession expense is analogous to grant revenue. By the time the right-of-use asset is returned to the lessor, the unearned revenue related to the subsidized portion has been fully amortized.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Option 1 – **Continue** with the approach in draft ED 64

Advantages	Disadvantages
The lessor's unwinding of the initial concession expense over the lease term and the lender's unwinding of the initial write down of a loan to fair value are both consistently treated as a revenue item.	<ul style="list-style-type: none">• It creates a mismatch between the recognition of expense and revenue for the same subsidized component. The expense is recognized on day one, whereas the revenue is recognized over the lease term. Users might not understand this mismatch for essentially the same subsidized component.• Might not meet the definition of revenue.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 2 – Treat the credit entry as revenue on day one**
 - Rationale 1:
 - Recognizing the subsidized component as revenue on day one would better meet the objectives of public sector financial reporting and the qualitative characteristics of financial information because of the mismatch in the timing of recognition in Option 1 for essentially the same subsidized component.

Advantages	Disadvantages
Zero impact on surplus or deficit	<ul style="list-style-type: none">• Recognizing revenue on day one when the lessor still has an obligation to provide access to the underlying asset to the lessor is misleading.• Might not meet the definition of revenue

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 3 – Scope all concessionary leases out of ED 64** and consider the accounting for all concessionary leases in the revenue and non-exchange expense projects
 - Rationale:
 - ED only for leases at market terms and defer consideration of accounting for concessionary leases to the exposure draft stage of the revenue and non-exchange expenses project.
 - Reverse a previous IPSASB decision to provide guidance on concessionary leases in ED 64.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 3 – Scope all concessionary leases out of ED 64** and consider the accounting for all concessionary leases in the revenue and non-exchange expense projects

Advantages	Disadvantages
Holistic approach to non-exchange revenue and expense.	IPSASB's constituents expectations frustrated.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 4 – Scope concessionary leases for lessors out of ED 64 and consider accounting for lessor concessionary leases in the non-exchange expenses project**
 - Rationale:
 - ED only for concessionary leases for lessees because the guidance is consistent with IPSAS 23.
 - Reverses a previous IPSASB decision to provide guidance on concessionary leases in ED 64.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 4 – Scope concessionary leases for lessors out of ED 64 and consider accounting for lessor concessionary leases in the non-exchange expenses project**

Advantages	Disadvantages
<ul style="list-style-type: none">• Consistency with IPSAS 23.• Receive feedback from constituents.	<p>Frustrate expectations of IPSASB's constituents on lessor accounting.</p>

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- **Option 6 – Treat the subsidy expense as a **trigger of impairment** to the lessor’s underlying asset and recognize an impairment expense on day one**
 - Rationale:
 - Recognize an initial impairment of the underlying asset as an expense and subsequently a reversal of that expense, either progressively over the term of the lease (on the basis that the closer to the end of the lease term, the less impaired the underlying asset is), or at the end of the lease term.

Lessor—Credit Entry (Liability–Unearned Revenue) Related to Subsidy in Concessionary Leases (Agenda Item 7.2.6)

- Option 6 – Treat the subsidy expense as a **trigger of impairment** to the lessor’s underlying asset and recognize an impairment expense on day one

Advantages	Disadvantages
<ul style="list-style-type: none">• “Similar” to concessionary loan with write-down of the loan to fair value.	<ul style="list-style-type: none">• Complexity;• Requiring an impairment charge for all underlying assets in lease contracts regardless of the lease terms might be considered an accounting construct, which does not reflect economic reality.

Transitional Provisions (Agenda Item 7.2.7)

- **Lessee accounting**
 - Based on IFRS 16.
- **Lessor accounting**
 - Mirrors IFRS 16 requirements for lessees to the extent possible.
- **Staff's recommendation**
 - Adopt the transitional requirements in draft ED 64.
- **Matter for consideration**
 - Does the IPSASB agree with the transitional provisions proposed by staff in draft ED 64?

Approval of draft Exposure Draft 64, *Leases and Exposure Period* (Agenda Item 7.2.8)

- **Approval of draft Exposure Draft 64**
 - Shaded for paragraphs agreed by IPSASB.
 - In struck through, for which the IPSASB already took a decision to depart from IFRS 16 in lessor accounting.
 - In underlined related to the Exposure Draft specific guidance on lessor accounting.
 - Non-authoritative (illustrative examples and basis for conclusions) sections:
 - Modified the IFRS 16 terminology to IPSASs and public sector terminology; and
 - Included additional illustrative examples on concessionary leases, including short-term concessionary leases.

Approval of draft Exposure Draft 64, *Leases* and Exposure Period (Agenda Item 7.2.8)

- **Matter for consideration**
 - Does the IPSASB agree to vote to approve for publication ED 64?

Approval of draft Exposure Draft 64, *Leases* and Exposure Period (Agenda Item 7.2.8)

- **Exposure period of ED 64**
 - The standard consultation period for EDs is four months.
 - Staff considers that four months is appropriate for a document of this size and complexity.
 - The expected publication date is mid-November 2017. The recommended comment end date in March 15, 2018.
- **Matter for consideration**
 - Does the IPSASB agree to a March 15, 2018 comment closing date?



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