

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: September 20–23, 2016

From: João Fonseca

Agenda Item 8

For:

☐ Approval

☒ Discussion

☒ Information

LEASES

Project summary	Develop revised requirements for lease accounting covering both lessees and lessors in order to maintain convergence with IFRS 16, <i>Leases</i> , to the extent appropriate. The project will result in a new IPSAS that will replace IPSAS 13, <i>Leases</i> .	
Meeting objectives	Topic	Agenda Item
Project management	Instructions up to June 2016 meeting	8.1.1
	Decisions up to June 2016 meeting	8.1.2
	Project roadmap	8.1.3
Decisions required at this meeting	Lessor—Applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model)	8.2.1
	Lessor—IPSAS 13, IFRS 16 and right-of-use model recognition and requirements (including property and vehicle leases)	8.2.2
	Sale and leaseback transactions	8.2.3
	Leases that transfer ownership	8.2.4
	Lessee—Recognition Exemptions—Threshold of leases for which the underlying asset is of low value	8.2.5
Other supporting items	Leases in the public sector—Fact patterns	8.3.1
	Lessor accounting—History of IASB's project	8.3.2

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8.1.1

INSTRUCTIONS UP TO JUNE 2016 MEETING

Meeting	Instruction	Actioned
June 2016	<p>The IPSASB directed staff to bring the following issues and items to future meetings meeting:</p> <ul style="list-style-type: none">• Recognition exemptions and threshold of leases of low-value assets;• Presenting some fact patterns based on several types of “peppercorn leases”;• Explaining in more detail the IFRS 16 lessor accounting model;• Analyzing how the service concessions model in IPSAS 32, <i>Service Concessions Arrangements: Grantor</i> might be applied for the lessor accounting and compare this approach with IFRS 16 lessor accounting by using some fact patterns;• Present a high level history of the IASB’s project to explore why and when IASB modified their proposals for lessor accounting;• Explain how property and vehicle leases are accounted for in existing guidance in IPSAS 13 and in IFRS 16.	

DECISIONS UP TO JUNE 2016 MEETING

Date of Decision	Decision
June 2016	<ul style="list-style-type: none">• To apply the right-of-use model to lessee accounting in the Exposure Draft on Leases;• To include in the Basis for Conclusions in the Exposure Draft on Leases the advantages and disadvantages identified by the IPSASB and the reason for IPSASB's decision on the extent of adoption of the right of use model;• To adopt the IFRS 16 recognition exemptions in the Exposure Draft on Leases;• Recognition exemptions should be an option, rather than a requirement, in the Exposure Draft on Leases;

LEASES PROJECT ROADMAP

Meeting		Objective: IPSASB to consider:
2016	December	<ol style="list-style-type: none"> 1. Objective, Scope and Definitions (except definition of a lease) 2. Identifying a lease: Lease versus Service versus Service Concessions 3. "Peppercorn leases"—"Geography" in IPSASs literature 4. Leases—Measurement (including "peppercorn leases") 5. Lessee—Reassessment of the lease liability and lease modifications 6. Application Guidance 7. Review of first draft ED
2017	March	<ol style="list-style-type: none"> 1. Terminology: Conceptual Framework 2. Presentation: lessee and lessor 3. Disclosures: lessee and lessor (including "peppercorn leases") 4. Review of draft ED 5. Effective date and transition 6. Approval of ED
	June	Exposure period
	September	
	December	<ol style="list-style-type: none"> 1. Review of Responses: Objective, Scope and Exemptions 2. Review of Responses: Identifying a lease 3. Review of Responses: Recognition and measurement—Lessee and lessor
2018	March	<ol style="list-style-type: none"> 1. Review of Responses: Presentation—Lessee and lessor (including "peppercorn leases") 2. Review of Responses: Disclosures—Lessee and Lessor (including "peppercorn leases") 3. Review of Responses: Sale and Leaseback Transactions 4. Review of Responses: Terminology—Conceptual Framework
	June	<ol style="list-style-type: none"> 1. Review of draft IPSAS 2. Approval of new IPSAS

Lessor—Applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model)**Questions**

1. Does the IPSASB agree with staff's analysis of the applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model)?

Detail

2. At the June 2016 meeting the IPSASB formed a view that the appropriateness of the risks and rewards model for lessor accounting in IFRS 16 for public sector financial reporting is a key issue. Therefore, the IPSASB requested staff to analyze how the grant of a right to the operator model in IPSAS 32, *Service Concessions Arrangements: Grantor* might be applied for lessor accounting as both transactions are granting rights and obligations over underlying assets: the grantor grants the right to operate (right-to-operate model) and the lessor grants the right to use an underlying asset (right-of-use model).
3. Staff notes that the IASB's decision to retain the risks and rewards model in IFRS 16 was related to cost-benefit reasons advocated by some of the IASB's constituents¹.
4. [Appendix A](#) below provides an in-depth analysis of the applicability of the grant of a right to the operator model in IPSAS 32 to lessor accounting. In accordance with the direction from the IPSASB at the June 2016 meeting, this analysis focuses on the applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting, thereby, mirroring lessee accounting. As a consequence of this direction, staff did not analyze alternative lessor accounting models.
5. The main conclusions of the analysis of the right-of-use model in lessor accounting are that:
 - (a) It is consistent with the grant of a right to the operator model in IPSAS 32;
 - (b) Staff did not identify an economic reason not to adopt the right-of-use model for lessor accounting;
 - (c) It is consistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework); and
 - (d) Additional guidance on the distinction between a lease and a service concession may be needed in IPSASB's literature.
6. [Appendix B](#) shows a detailed analysis on how staff's proposals address the concerns raised by the IASB's constituents on the adoption of the right of use model for lessor accounting.
7. [Appendix C](#) summarizes the advantages and disadvantages of the right-of-use model and risks and rewards model for lessor accounting.

¹ See paragraph BC63 of IFRS 16

Decisions required

8. Does the IPSASB want to:
 - (a) Highlight further issues relevant to the analysis of the applicability of the IPSAS 32 grant of a right to the operator model to lessor accounting?
 - (b) Provide additional guidance on the distinction between a lease and a service concession? If so, should that additional guidance be in the ED on Leases or as an amendment to IPSAS 32?
 - (c) Adopt the right-of-use model to lessor accounting or retain the risks and rewards model in the new IPSAS on Leases?

Appendix A—Analysis of the applicability of IPSAS 32 grant of a right to the operator model to lessor accounting (right-of-use model)

Introduction

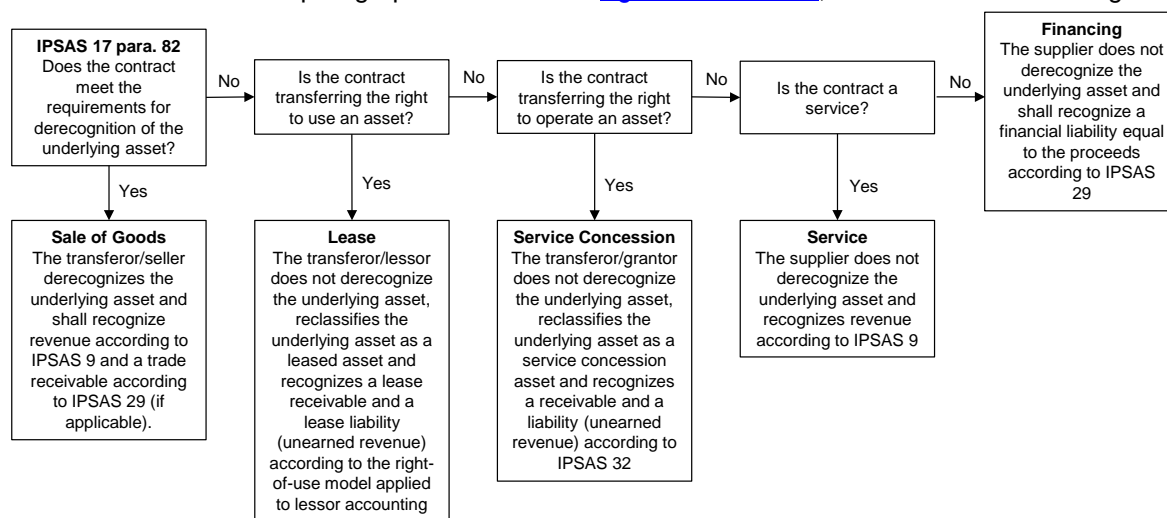
1. This Agenda Item has two sections. The first section is related to the relationship between leases and other transactions.
2. The second section is related to the applicability of the grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model). In this section:
 - (a) The rights and obligations of leases and service concession are compared;
 - (b) The requirements of the right-of-use model are applied to lessor accounting;
 - (c) The consistency of the right-of-use model is analyzed for consistency with the Conceptual Framework and IPSAS 32, *Service Concession Arrangements: Grantor* is analyzed; and
 - (d) The requirements of the right-of-use model applied to lessor accounting with IASB's Exposure Drafts are analyzed.

1. Relationship between leases and other transactions

3. The decision tree below shows the steps necessary to apply the right-of-use model to lessor accounting and the relationship of such an approach with other transactions.

Figure 1 – Decision tree on applying the right of use model for lessor accounting

4. As discussed below in paragraphs 21-22 and in [Agenda Item 8.2.1](#), staff is of the view that granting



only the right to use the underlying asset does not justify derecognition of the underlying asset from the lessor's financial statements. In other words, the derecognition of the underlying asset from the lessor's financial statements should only be made when there is a sale.

5. Therefore, the first step in Figure 1 above shows that the transferor/seller derecognizes the underlying asset² and recognizes revenue according to IPSAS 9, *Revenue from Exchange Transactions*³ only if the contract meets the requirements for derecognition of the underlying asset in paragraph 82 of IPSAS 17.
6. IPSAS 9 applies a risks and rewards model to recognize revenue from the sale of goods. IPSAS 13 uses a risks and rewards model for the classification of leases. This means that both standards have the same accounting model for derecognition of the underlying asset. In other words, a finance lease is viewed as financing the sale of the underlying asset. Therefore, IPSAS 13 requires the derecognition of the underlying asset from the lessor's financial statements and its recognition in the lessee's financial statements.
7. When the right-of-use model is applied to lessor accounting, a lease is viewed as financing the right to use an underlying asset and not financing the sale of the underlying asset.
8. The financing of the sale of the underlying asset will be equivalent to the "old" finance lease where:
 - (a) The seller derecognizes the underlying asset; and
 - (b) The buyer recognizes the underlying asset;
9. Staff notes that paragraph 28 of IPSAS 9, has additional requirements to recognize revenue that needs to be taken into consideration in a sale of goods. Paragraphs 29-32 of IPSAS 9 also provide additional guidance on the transfer of the risks and rewards of ownership of goods.
10. Following the steps in Figure 1, if the contract does not meet the requirements for derecognition of the underlying asset, then the entity needs to assess whether it is a lease, a service concession, a service or a financing transaction. IFRS 16 provides extensive guidance to identify a lease in a contract⁴ and IPSAS 32, *Service Concession Arrangements: Grantor* also provides some guidance on accounting for service concession arrangements⁵.
11. In the scenario of service, a Task Based Group member noted that in most cases of provision of services there is no underlying asset being used (e.g. cleaning services). In this case, the contract cannot be classified as a lease or as a service concession and there is no underlying asset to be derecognized.
12. In the last scenario of financing, the contract refers to an underlying asset, but the contract does not meet the requirements for derecognition and the proceeds is a financial liability (loan) accounted according to IPSAS 29, *Financial Instruments: Recognition and Measurement*. For example, the underlying asset may be used as collateral for a loan from a bank.
13. As the IASB does not have an equivalent Standard for lessor accounting (IPSAS 32 performs that role), staff is not sure whether further guidance should be provided in IPSASB's literature and where.

² Staff notes that the reference to a finance lease in paragraph 84 of IPSAS 17 would have to be removed as a consequential amendment of the new IPSAS on Leases if the right-of-use model is applied to lessor accounting.

³ See paragraph 84 of IPSAS 17.

⁴ See paragraphs 9-17 and B9-B33 of IFRS 16.

⁵ See paragraph IG2 of IPSAS 32.

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8.2.1

14. The TBG noted that many times the lease contract contains several non-lease components. Paragraphs 12-17 of IFRS 16 provide guidance on how to separate the components of a contract. Staff will bring f the IFRS 16 guidance to identify a lease to the December 2016 meeting for IPSASB's consideration.

II. Applicability of IPSAS 32 grant of a right to the operator model to lessor accounting

II.A. Rights and obligations of leases and service concessions

15. Table 1 below summarizes the rights and obligations under a lease and a service concession (grant of a right to the operator model, with additional deferred payments from the operator related to the use of a pre-existing underlying asset)^{6 7}.

Table 1 – Lease and Service Concession—Rights and Obligations

Rights and obligations	Lease		Service Concession	
	Lessor	Lessee	Grantor	Operator
Core rights of the lessor/grantor inherent to the underlying asset				
Title to the underlying asset (legal ownership)	X		X	
Right to sell the underlying asset with the agreement attached	X		X	
Right to sell or re-lease/service concession the underlying asset at the end of the agreement term	X		X	
Right to use the underlying asset at the end of the agreement term	X		X	
Other rights and obligations of the lessee/operator				
Right to operate the underlying asset during the agreement		X		X
Obligation to maintain the underlying asset during the agreement	X	X		X
Right to charge users		X		X
Obligation to return the underlying asset at the end of the agreement term		X		X
Obligation to pay for the use of the asset		X		X
Specific rights related to the type of agreement				
Right to determine how to use the underlying asset (services provided, users of the services and management of the asset)		X	X	
Right to determine how it generates future economic benefits (price)		X	X	

16. Table 1 above shows that the only differences between a lease and a service concession are that:

(a) In a lease the lessee controls the use of the underlying asset throughout the lease term;

⁶ For simplification reasons, from now on when staff is referring to service concession it is in the context of the grant of a right to the operator model, with additional deferred payments from the operator related to the use of a pre-existing underlying asset. Staff notes that according to paragraph 18 of IFRIC 12, *Service Concession Arrangements*, “the right to charge users is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.”

⁷ See paragraphs BC37-BC39 of IFRS 16, paragraphs 11, 12 and 17 of IFRIC 12 and paragraphs 14, 15, 24, 25 and 26 of IPSAS 32.

- (b) In a service concession the operator does not control the use of the underlying asset throughout the service concession term as it has only access to operate the underlying asset; and
 - (c) The operator has at least the obligation to maintain the underlying asset in a service concession. In contrast, in a lease agreement that obligation can be shared between the lessee, the lessor or can apply only to the lessee or only to the lessor, depending on the terms of the contract.
17. Staff notes that the right to use an asset provides more rights to the lessee than a right to access to operate an asset and this influences the level of payments from the lessee/operator to the lessor/grantor. From an economic perspective, it is likely that the more rights to the underlying asset the lessee/operator receives from the lessor/grantor, the greater the amount of the payments to the lessor/grantor.
 18. Staff notes that the level and schedule of payments does not determine the classification of the transaction. Instead, it is the type of rights over the underlying asset that determines the classification of the transaction.
 19. If the lessor/grantor still retains the core rights identified in Table 1 that allows them to transfer the underlying asset to a third party.
 20. The following paragraphs provide the requirements of the right-of-use model applied to lessor accounting sub-divided by the elements of the lease.

II.B. Analysis of Requirements of the Right-of-use Model applied to Lessor Accounting

II.B.1. Underlying asset—Recognition/Derecognition

A. Right-of-use model applied to lessor accounting

21. The analysis in Table 1 above leads staff to conclude that a lessor/grantor transferring the right to use/operate an underlying asset does not justify its derecognition from the lessor's/grantor's statement of financial position and its recognition in the lessee's/operator's statement of financial position, as the lessor/grantor still retains core economic rights inherent to the underlying asset⁸, as a consequence of its legal ownership, from which it can still obtain economic benefits. As is it said below in paragraph 33, the conditions in the Conceptual Framework for its derecognition have not been met.
22. Staff is of the view that granting the right to use an underlying asset does not derecognize the historical cost incurred by the lessor to acquire it as the lessor only transfers the right to use an underlying asset and not the underlying asset itself. The underlying asset will continue to be used, although by a third party (the lessee), and will continue to provide economic benefits to the lessor through the lease payments made by the lessee.

⁸ Staff notes that the IASB also concluded that lessor's rights retained in the underlying asset meet the definition of an asset according to their Conceptual Framework (see paragraph BC39 of IFRS 16).

B. Consistency with IPSAS 32

23. IPSAS 32 is the mirror of IFRIC 12, *Service Concession Arrangements*. Both pronouncements present accounting requirements for granting and receiving rights over an underlying asset: the former from the grantor side; the latter from the operator side.
24. IPSAS 32 and IFRIC 12 follow a control based approach to recognize the underlying asset. Under IPSAS 32 the grantor does not derecognize the underlying asset in a service concession and, therefore, the operator does not recognize the underlying asset.
25. According to paragraph 9 of IPSAS 32 the grantor:
 - (a) Controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) Controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
26. In the case of a “whole-of-life” asset only (a) needs to be met to be considered for the underlying asset to be within the scope of IPSAS 32.
27. In a lease, the lessee controls or regulates the services provided with the asset, to whom and at what price and does not control—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
28. Staff is of the view that this criterion should be used only to classify the transaction (lease or service concession) and not to determine the derecognition of the underlying asset. This view is reinforced by the fact that according to BC2 of IPSAS 32 “the IPSASB concluded that the scope of this Standard should be the **mirror of IFRIC 12**, in particular, the criteria under which the grantor recognizes a service concession asset (see paragraphs BC11–BC16). The rationale for this decision is that this approach would require both parties to the same arrangement to apply the same principles in determining which party should **recognize the asset** used in a service concession arrangement. Thus, arrangements in which the criteria for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset) are not satisfied, are outside the scope of this IPSAS. The IPSASB considers that this approach minimizes the possibility that an asset will be accounted for by both of the parties, **or by neither party**” [emphasis added].
29. During the development of IPSAS 32 the IPSASB considered three models⁹:
 - (a) The risks and reward model;
 - (b) The rights and obligations model; and
 - (c) The control model;
30. “The IPSASB concluded that a control-based approach was the most effective means to determine whether the grantor should recognize the asset. The IPSASB concluded that if a control-based approach is used, it should be consistent with IFRIC 12, for the same reasons cited in paragraph BC2. [...]”¹⁰

⁹ See paragraphs BC11–BC16 of IPSAS 32.

¹⁰ Paragraph BC16 of IPSAS 32

31. Staff has not identified an economic reason why this rationale should not be applied to lease accounting.
32. The right-of-use model in lessor accounting would also be consistent with grant of a right to the operator in IPSAS 32 with an existing asset in the case of “whole-of-life” assets because:
 - (a) In a lease, the lessee will always recognize a right-of-use asset and not the underlying asset;
 - (b) In a service concession, the operator will always recognize an intangible asset or a financial asset and not the underlying asset;
 - (c) In a lease, the lessor does not derecognize the underlying asset;
 - (d) In a service concession, the grantor does not derecognize the underlying asset.

C. Consistency with Conceptual Framework

33. Not derecognizing the underlying asset from the lessor’s financial statements is consistent with the Conceptual Framework because the criteria for derecognition have not been met. The underlying asset still meets the definition of an element, can be measured in a way that meets the qualitative characteristics and there is no existence uncertainty or measurement uncertainty.

D. Comparison with IASB’s Exposure Drafts

34. Not derecognizing the underlying asset from the lessor’s financial statements is also consistent with the IASB’s performance obligation approach in the 2010 Exposure Draft and the approach for Type B¹¹ leases in the 2013 Exposure Draft.
35. According to paragraph BC10(ii) of IFRS 16 (see [Appendix B](#) below) “many respondents opposed the performance obligation approach. In the view of those respondents, the approach would artificially inflate a lessor’s assets and liabilities.”
36. Staff does not agree with this view because the values of the underlying asset and the lease asset in lessor’s financial statements have:
 - (a) Different economic natures—The value of the underlying asset is the historical cost incurred to purchase it and the lease asset is the present value of future lease payments that the lessor will receive for granting the right to use the underlying asset as a result of completely different transactions.
 - (b) Different confirmatory or predictive values—The value of the underlying asset confirms the historical cost incurred to purchase it and the value of the lease asset confirms or predicts the present value of future lease payments that the lessor will receive for granting the right to use the underlying asset.
37. According to the [IASB/FASB Staff Paper](#), many respondents disagreed with the IASB’s approach to Type B leases for several reasons identified in [Appendix B](#) below. Staff notes that the IASB’s Type B leases have different economics from the right of use model applied to lessor accounting (see [Agenda Item 8.3.2](#)).

¹¹ Leases for which a lessee was expected to consume an insignificant portion of the economic benefits embedded in the underlying asset.

38. As explained in [Appendix B](#) and in the above paragraphs 19, 20 and 32, staff did not identify any economic reason that warrants derecognition of the underlying asset from the lessor's financial statements by applying the right-of-use model.

E. Task Based Group views

39. A Task Based Group member raised the issue that the three diverging criteria identified in paragraph 16 above between service concessions and leases could be an obstacle in applying the grantor model to a lease contract because they are not always crystal clear.
40. Another Task Based Group member proposes a derecognition approach to the underlying asset. In this approach the portion of the underlying asset related to the lease receivable would be derecognized and a residual asset would be recognized. According this Task Based Group member the asset itself is controlled but it has lost or changed some of its economic characteristics: it has relinquished the right to be used during the lease period.
41. Staff notes that this approach is in line with the IASB's derecognition approach in the 2010 Exposure Draft and Type A¹² of Leases in the 2013 Exposure Draft. [Appendix B](#) provides an overview of the IASB constituents' reasons for rejecting the Type A of Leases in the 2013 Exposure Draft.

II.B.2. Underlying asset—Measurement

42. Staff having concluded that a lease does not justify derecognition of the underlying asset from the lessor's statement of financial position, then the next question is what measurement basis should be applied?
43. As stated in paragraph 22, staff is of the view that granting the right to use an underlying asset does not negate the historical cost incurred by the lessor to acquire it and recognize in its financial statements. Therefore, staff is of the view that historical cost is an appropriate measurement basis for the underlying asset.
44. It can be argued that a market value measurement can also be applied to the underlying asset in subsequent measurement in order to better measure the economic benefits that the lessor can still obtain from the rights retained in the underlying asset beyond the right-of-use transferred to the lessee. In this case, the measurement of the economic benefits of the rights retained in the underlying asset must be separate from the economic benefits embedded in the lease receivable, in order to avoid duplication of values or double counting in the lessor's statement of financial position.
45. The lessor should continue to recognize depreciation and impairment, if required. If the lease contract stipulated that the lessee should return the underlying asset in its original or enhanced condition, then the lessor should not depreciate the underlying asset during the lease term.
46. If the underlying asset is an investment property as defined in IPSAS 16, *Investment Property* and measured at fair value then the lessor should not revalue under the right-of-use model in order to avoid double counting in the lessor's statement of financial position. The double counting usually occurs where entities determine the fair value using a valuation technique that considers the present value of future lease payments.

¹² Leases for which a lessee was expected to consume a significant portion of the economic benefits embedded in the underlying asset.

47. Staff notes that according to paragraph 49 of IPSAS 16, "The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions."

II.B.3. Lease receivable—Recognition

A. Right-of-use model applied to lessor accounting

48. With the transfer of the right to use the underlying asset from the lessor to the lessee, the lessor gains the right to receive lease payments (the lease receivable). The lease receivable would be recognized in the lessor's statement of financial position.

B. Comparison with IPSAS 32

49. Under IPSAS 32, the grantor recognizes a receivable in the cases where the operator provides a stream of payments or other consideration to the grantor for the use of a service concession asset that already exists over the term of the service concession arrangement.
50. This requirement is consistent with the recognition of a lease receivable in the lessor's statement of financial position by applying the right-of-use model.

C. Consistency with the Conceptual Framework

51. The lease receivable meets the definition of an asset¹³ as defined in the Conceptual Framework because:
- (a) It is a resource with ability to generate economic benefits to the lessor—Lease payments from the lessee to the lessor;
 - (b) Presently controlled by the lessor—The lessor can sell or securitize it; and
 - (c) It is a result of a past event—As a result of the lease contract and the underlying asset being made available to the lessee.

D. Comparison with IASB's Exposure Drafts

52. The recognition of the lease receivable is consistent with the performance obligation approach in IASB's 2010 Exposure Draft.
53. [Appendix B](#) shows a detailed analysis on how staff's proposal addresses the concerns raised by the IASB's constituents to the performance obligation approach. Staff did not identify any economic reason not to recognize the lease receivable.

II.B.4. Lease receivable—Measurement

54. The measurement of the lease receivable will be discussed at the 2016 December meeting along with the measurement of the right-of-use asset in the lessee's financial statements and the

¹³ Staff notes that the IASB also reached the same conclusion that the lease receivable meets the definition of an asset according to the IASB's Conceptual Framework. See paragraphs BC35 and BC36 of IFRS 16, *Leases*.

measurement of “peppercorn leases”, including the subsidized component. The Task Based Group raised several important issues related to measurement that needs a full session to analyze them.

II.B.5. Deferred inflows of resources related to unearned revenue

A. Right-of-use model applied to lessor accounting

- 55. The lease receivable includes leases payments that are related to future periods. Therefore, the grantor will have a deferred inflow of resources related to unearned revenue at the commencement date matching the lease receivable.
- 56. The right-of-use model applied to lessor accounting foresees the recognition of a deferred inflow of resources related to unearned revenue as a liability.

B. Consistency with IPSAS 32

- 57. IPSAS 32 provides guidance to account for payments from the operator to the grantor in two cases:
 - (a) Grant of a right to the operator model with existing asset¹⁴; and,
 - (b) Other revenues not related to paragraph (a)¹⁵.
- 58. In both cases, the grantor recognizes the unearned revenue as a liability until the conditions for revenue recognition are met¹⁶. The timing of revenue recognition by the grantor is determined by the terms and conditions of the arrangement—this is likely to be as the grantor provides the operator with access to the service concession asset¹⁷. The same timing applies to leases.
- 59. Staff's proposal is consistent with IPSAS 32 because the unearned liability and revenue would also be recognized under the same conditions.

C. Consistency with Conceptual Framework

- 60. The Conceptual Framework does not identify other obligations and other resources as elements. Paragraphs BC5.55 and B.56 explains that the IPSASB “acknowledges that there may be circumstances under which the six elements defined in the Conceptual Framework may not provide all the information in the financial statements that is necessary to meet users’ needs” and “the circumstances under which other obligations and other resources will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards”.
- 61. The deferred inflow of resources arises from the lease receivable. Staff is of the view that the deferred inflow of resources is a liability because the lessor has an obligation to make the underlying asset available for use by the lessee during the lease term and, therefore, the timing of revenue recognition is over the term of the lease, rather than immediately. In other words, until the criteria for recognition

¹⁴ Paragraphs 24-26 of IPSAS 32

¹⁵ Paragraph 30 of IPSAS 32

¹⁶ See paragraphs AG47 and AG57 of IPSAS 32 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

¹⁷ See paragraphs AG47 and AG56 of IPSAS 32 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

of revenue have been satisfied, staff is of the view that the credit should be recognized as a liability as an unearned revenue.

- 62. Staff acknowledges that the deferred inflows of resources related to unearned revenue does not meet the definition of a liability as defined in the Conceptual Framework because there is not an outflow of service potential or economic benefits from the entity.
- 63. However, the Basis for Conclusions to the Conceptual Framework allows the recognition of other obligations and other resources in the financial statements, provided that it meets the user's needs and it is explained in the Bases for Conclusions of specific standards.
- 64. Staff is of the view that the recognition of deferred inflows of resources related to the unearned revenue as a liability meets these two conditions and, therefore, it is allowed under the Conceptual Framework.

D. Comparison with IASB's Exposure Drafts

- 65. The recognition of the unearned revenue as liability is consistent with the performance obligation approach in IASB's 2010 Exposure Draft.
- 66. [Appendix B](#) shows a detailed analysis of how staff's proposal addresses the concerns raised by the IASB's constituents on the performance obligation approach. Staff did not identify any economic reason not to recognize the lease receivable.

Conclusion

- 67. The main conclusions of the analysis of the right-of-use model in lessor accounting are that:
 - (a) It is consistent with the right to operate model in IPSAS 32;
 - (b) Staff did not identify an economic reason not to adopt the right-of-use model to lessor accounting;
 - (c) It is consistent with The Conceptual Framework; and
 - (d) Additional guidance on the distinction between a lease and service concessions may be needed in IPSASB's literature.
- 68. In addition, the right-of-use model in lessor accounting:
 - (a) Reinforces accountability and decision making in the public sector because the underlying asset is always recognized in the lessor's financial statements;
 - (b) Enhances consolidation procedures within the public sector for public sector entities that apply IPSAS;
 - (c) Prevents the non-recognition of the underlying asset in both the lessee's and the lessor's financial statements, contrary to what happens in IFRS 16; and
 - (d) Prevents distortion of the financial statements in cases where the public sector entity is both a lessee and a lessor in different lease contracts.

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Appendix B—Lessor accounting—IASB's constituents concerns with IASB's proposals¹⁸ and staff's comments

IASB's constituents concerns with IASB's proposals	Staff's Comments
Responses to 2010 Exposure Draft	
<p>Paragraph BC10 of IFRS 16</p> <ul style="list-style-type: none"> • “(i) some respondents were concerned that the dual accounting model proposed for lessors was not consistent with the single accounting model proposed for lessees. • (ii) many respondents opposed the performance obligation approach. In the view of those respondents, the approach would artificially inflate a lessor's assets and liabilities. • (iii) some respondents recommended applying the derecognition approach to all leases. However, many disagreed with the proposal to prevent a lessor from accounting for the effects of the time value of money on the residual asset. • (iv) some respondents thought that the lessor accounting requirements in IAS 17, <i>Leases</i> and FASB Topic 840' <i>Leases</i> work well in practice and supported retaining those requirements.” 	<ul style="list-style-type: none"> • Staff's proposal is a single accounting model for both lessee and lessor. • Staff is of the view that granting a right to use the underlying asset does not artificially inflate a lessor's assets and liabilities because: <ul style="list-style-type: none"> (a) It does not remove the historical cost incurred by the lessor to acquire the underlying asset and recognized in its financial statements; (b) It does not justify the derecognition of the underlying asset from the lessor's statement of financial position and its recognition in the lessee's statement of financial position; (c) In order to avoid duplication of values in the statement of financial position, the subsequent measurement of the underlying asset using the optional revaluation model must only reflect the economic benefits that the entity is expected to receive after the lease term. • Staff's proposal does not include a residual asset. • Staff considers this view on IAS 17 lessor accounting is specific to the business sector and, therefore, might not apply to the public sector.
Responses to 2013 Exposure Draft	

¹⁸ Staff suggests reading [Agenda Item 8.3.2—Lessor accounting—History of IASB's project](#) before reading this appendix.

IASB's constituents concerns with IASB's proposals	Staff's Comments
<p>Paragraph BC14(c) of IFRS 16</p> <ul style="list-style-type: none"> • “the majority of stakeholders disagreed with the proposed lessor accounting model. Most of these stakeholders were of the view that the previous lessor accounting model in IAS 17 was not fundamentally flawed and should not be changed.” <p>IASB/FASB Staff Paper</p> <ul style="list-style-type: none"> • “63. Many users disagree with the proposed changes to lessor accounting and, in particular, the effects that the proposed accounting would have on a lessor's income statement. Those who follow lessors of long-lived assets (for example, aircraft, drilling rigs, rail cars) do not support the proposed changes, preferring to receive revenue information that is relatively predictable and that often reflects actual cash inflows, as this is what they receive for operating leases under existing requirements. They are concerned about the potential volatility in amounts recognized in a lessor's income statement under the proposals, particularly when the second-hand market for leased assets is volatile. They are of the view that the proposed accounting would reduce transparency for some lessors, such as drilling rig lessors. • 64. A majority of other constituents do not support the proposed dual model. This is because, in their view, it does not result in improved financial reporting for many lessors of equipment, including: <ul style="list-style-type: none"> (a) Lessors of long-lived assets (for example, drilling rigs, aircraft, or rail cars) (b) Lessors of multi-tenanted equipment (for example, telecommunications towers or fiber cables) (c) Lessors who provide substantial services with their leases (d) Lessors who release assets. <p>65. These constituents disagree with such lessors applying Type A accounting because, in their view:</p> <ul style="list-style-type: none"> (a) Derecognizing the underlying asset and recognizing a lease receivable and a residual asset does not appropriately reflect those lessors' business models. They consider those lessors to be in the business of managing assets over the entire economic lives of those assets, rather than over any individual lease term. 	<ul style="list-style-type: none"> • Staff considers this view on IAS 17 lessor accounting is specific to business sector user's needs and, therefore, might not best meet users' needs in the public sector. • Staff's proposal is to recognize income on the basis of the pattern of use of the underlying asset by the lessee or, if undetermined, the straight-line method. Although the wording is different, this concept of revenue recognition is consistent with paragraph 25 of IPSAS 32 where the grantor recognizes revenue and reduces the liability according to the economic substance of the service concession arrangement. • Staff's proposal is applicable to all types of assets except the ones excluded from IFRS 16. Staff did not find an economic reason why the lessor should account in a different way from the lessee. • Staff's does not propose derecognition of the underlying asset.

IASB's constituents concerns with IASB's proposals	Staff's Comments
<p>(b) It is inappropriate for those lessors to derecognize underlying assets when the lessor retains an interest in the "whole" underlying asset and can borrow money using that underlying asset as collateral.</p> <p>(c) The proposed effects on the income statement do not appropriately reflect the economics of leases entered into by those lessors. In particular, they disagree with the characterization of lease income as interest income and the front-loaded pattern of income recognition, particularly when the secondhand market for leased assets is volatile.</p> <p>(d) Those lessors' leases are priced similarly to property leases and are not priced on a cost-plus-return basis that is typical of many equipment leases.</p> <p>66. Some constituents are particularly concerned about the costs and complexity of the proposed dual lessor accounting model, stating that:</p> <p>(a) There would be costs involved in applying any new classification guidance and in setting up the accounting systems required for Type A accounting</p> <p>(b) The dual model is complex, particularly the judgments that need to be made in classifying leases and in applying the Type A model (for example, estimating future residual values).</p> <p>67. Some constituents also disagree with the lessor model because they think that the focus on the lessee's consumption of economic benefits in determining when and in what way profit is recognized is inconsistent with the Boards' new revenue recognition model.</p> <p>68. Finally, some constituents disagree with the lessor model because they think that the dual model, especially Type B accounting, is inconsistent with the ROU model and the lessee accounting model.</p> <p>69. For these reasons, many constituents do not think that the proposed dual model would result in an improvement in financial reporting when compared to the existing lessor model in IAS 17 and Topic 840.</p>	<ul style="list-style-type: none"> • Staff's does not propose the derecognition of the underlying asset. • Staff's proposal include two types of revenue: interest revenue on the lease receivable and revenue from the reduction of the lease liability. • Staff's proposal is applicable to all types of assets, except the assets excluded in IFRS 16. • Staff proposes only one accounting model for lessors and, therefore, does not have the complexity raised by IASB's constituents of having two types of leases. • Idem • Staff's proposal allows revenue recognition according to the lessee's consumption of economic benefits and, if undetermined, on a straight-line basis consistent with IPSAS 32. • Staff's proposal is to apply the right-of-use model for lessor and lessee accounting. • As staff's proposal addresses the IASB's constituents' concern, staff is of the view that the right of use model improves financial reporting.

IASB's constituents concerns with IASB's proposals	Staff's Comments
<p>Basis for Conclusions to IFRS 16¹⁹</p> <ul style="list-style-type: none"> 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—indicating that the lessor accounting model in IAS 17 already provides users of financial statements with the information that they need. In addition, investors generally analyse the financial statements of individual entities (and not a lessee and lessor of the same underlying asset). Accordingly, it is not essential that the lessee and lessor accounting models are symmetrical. 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. 	<ul style="list-style-type: none"> These are IASB constituents' specific views that might not be coincident with IPSASB constituents' views. In the public sector users of general purpose financial reports of public sector entities many times do analyze the financial statements of the lessee and lessor of the underlying asset in order to better assess the risks of providing resources and in order to understand who controls the underlying asset for accountability and decision-making purposes. For example: a public sector entity, which is a specialized lessor for the public sector, issues bonds in the capital markets to finance purchases of assets from other public sector entities that will be leased-back. As bonds are issued in the name of the public sector entity and not in the name of the State or guaranteed by the State, lenders may require the underlying asset to be used as collateral for borrowing and understand who, in fact, controls the underlying assets. These are IASB constituents' specific views that might not be coincident with IPSASB constituents' views.

¹⁹ Paragraph BC61 of IFRS 16

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Appendix C—Advantages and disadvantages of the right-of-use model and risks and rewards model in lessor accounting

Criteria	Right-of-use Model		Risks and rewards Model	
	Advantages	Disadvantages	Advantages	Disadvantages
I – Objectives				
Accountability	Reinforces <i>accountability</i> because the public sector entity by always recognizing the lease receivable and not derecognizing the underlying asset provides “information about the entity’s management of the resources entrusted to it for the delivery of services to constituents and others, and its compliance with legislation, regulation, or other authority that governs its service delivery and other operations.” ²⁰	-	-	Impairs <i>accountability</i> because the public sector entity by derecognizing the underlying asset in a finance lease and not recognizing the lease receivable in an operating lease does not provide “information about the entity’s management of the resources entrusted to it for the delivery of services to constituents and others, and its compliance with legislation, regulation, or other authority that governs its service delivery and other operations.” ²¹
Decision-making	Reinforces <i>decision-making</i> because the public sector entity by always recognizing the lease receivable and not derecognizing the underlying asset provides information about the economic benefits embedded in the underlying asset from the cost, sale, re-lease or use of the underlying asset at the end of the lease term. This information would enable them to “make decisions about whether to provide resources to support the current and future activities of the government or other public sector entity” ²² .	-	-	Impairs <i>decision-making</i> because the public sector entity by derecognizing the underlying asset in a finance lease and not recognizing the lease receivable in an operating lease 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 at the end of the lease term. This information would enable them to “make decisions about whether to provide resources to support the current and future activities of the government or other public sector entity” ²³ .
II – Qualitative characteristics				

²⁰ Paragraph 2.8 of the *Conceptual Framework*

²¹ Idem

²² Paragraph 2.9 of the *Conceptual Framework*

²³ Idem

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Criteria	Right-of-use Model		Risks and rewards Model	
	Advantages	Disadvantages	Advantages	Disadvantages
Relevance	Reinforces <i>relevance</i> because the public sector entity by always recognizing the lease receivable and not derecognizing the underlying asset provides confirmatory value about the economic nature of resources used and a predictive value about the "sources of the resources that are intended to be allocated to providing services in the future" ²⁴ .	-	-	Impairs <i>relevance</i> because the public sector entity by derecognizing the underlying asset in a finance lease and not recognizing the lease receivable in an operating lease does not provide a confirmatory value about the economic nature of resources used and a predictive value about the "sources of the resources that are intended to be allocated to providing services in the future" ²⁵ .
Faithful Representation	Reinforces <i>faithful representation</i> because the approach provides a more faithful representation of the substance of the underlying transaction: leases are financing transactions.	-	-	Impairs <i>faithful representation</i> because mixes the right to use an underlying asset with the purchase of the underlying asset.
Understandability	Reinforces <i>understandability</i> about the economic nature of the assets used in service delivery: the lessor has the control of the underlying asset and the control of the lease receivable.	-	-	Impairs <i>understandability</i> about the economic nature of the assets used in service delivery: the lessor has the control of the underlying asset and the control of the lease receivable and does not recognize them in a finance lease and in an operating lease, respectively.
Timeliness	Public sector entities have to provide financial information on leases as financing at the same time as other financing activities.	-	-	Public sector entities do not provide financial information on leases as financing at the same time as other financing activities.
Comparability	Reinforces <i>comparability</i> between public sector entities that lease assets and public sector entities that are lenders.	-	-	Impairs <i>comparability</i> between public sector entities that lease assets and public sector entities that are lenders.
Verifiability	Reinforces <i>verifiability</i> because the recognition of the lease receivable and the non-derecognition of the underlying asset enables to demonstrate and assure users the assets that are used in service delivery.	-	-	Impairs <i>verifiability</i> because the public sector entity by derecognizing the underlying asset in a finance lease and not recognizing the lease receivable in an operating lease fails to demonstrate and assure users the assets that are used in service delivery.

III – Consistency with other aspects of the *Conceptual Framework*

²⁴ Paragraph 3.8 of the *Conceptual Framework*

²⁵ Idem

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Criteria	Right-of-use Model		Risks and rewards Model	
	Advantages	Disadvantages	Advantages	Disadvantages
Elements	Consistent with the <i>Conceptual Framework</i> because the underlying asset and the lease receivable meets the definition of an asset ²⁶ .	-	-	Not consistent with the <i>Conceptual Framework</i> because the public sector entity derecognizes the underlying asset in a finance lease and does not recognize the lease receivable in an operating lease although they meet the definition of an asset ²⁷ .
Recognition	Consistent with the <i>Conceptual Framework</i> because the underlying asset and the lease receivable meet the recognition criteria ²⁸ .	-	-	Not consistent with the <i>Conceptual Framework</i> because the public sector entity derecognizes the underlying asset in a finance lease and does not recognize the lease receivable in an operating lease although they meet the recognition criteria ²⁹ .
IV – Consistency with other IPSASs				
IPSAS 32	Consistent with IPSAS 32 because the grantor never derecognizes the underlying asset in both the liability model and the grant of a right to the operator model. IPSAS 32 is the mirror accounting of IFRIC 12, <i>Service Concession Arrangements</i> . ³⁰	-	-	The finance lease accounting requirements are inconsistent with IPSAS 32 because the grantor never derecognizes the underlying asset in both the liability model and the grant of a right to the operator model. IPSAS 32 is the mirror accounting of IFRIC 12, <i>Service Concession Arrangements</i> . ³¹
IPSAS 29	Consistent with IPSAS 29 because leases are in substance financing transactions.	-	-	The operating lease accounting requirements are inconsistent with IPSAS 29 because leases are in substance financing transactions.
V – Public Sector Specific Reasons				

²⁶ See paragraphs 5.6-5.13 of the *Conceptual Framework*.

²⁷ Idem

²⁸ See paragraph 6.2 of the *Conceptual Framework*.

²⁹ Idem

³⁰ Staff notes that according to BC2 of IPSAS 32 “the IPSASB concluded that the scope of this Standard should be the **mirror of IFRIC 12**, in particular, the criteria under which the grantor recognizes a service concession asset (see paragraphs BC11–BC16). The rationale for this decision is that this approach would require both parties to the same arrangement to apply the same principles in determining which party should **recognize the asset** used in a service concession arrangement. Thus, arrangements in which the criteria for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset) are not satisfied, are outside the scope of this IPSAS. The IPSASB considers that this approach minimizes the possibility that an asset will be accounted for by both of the parties, **or by neither party**” [emphasis added]. Staff did not identify an economic reason why these conclusions are not applied to lease accounting.

³¹ Idem

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Criteria	Right-of-use Model		Risks and rewards Model	
	Advantages	Disadvantages	Advantages	Disadvantages
Budgeting	For budgets based on IPSAS and in the cases of public sector entities that are lessees and lessors of the same underlying asset the appropriations for revenue and expense will match.	-	-	For budgets based on IPSAS and in the cases of public sector entities that are lessees and lessors of the same underlying asset the appropriations for revenue and expense will not match. There is the possibility of incurring expenses that meet the requirements for capitalization related to the underlying asset and no one recognizes the underlying asset.
VI – Other				
Centralized lessors	Prevents the underlying asset not being recognized in anyone's financial statements.	-	-	The finance lease accounting requirements permits the underlying asset not being recognized in anyone's financial statements.
Consolidation	For public sector entities that apply IPSAS, the consolidation procedures are improved because of the mirror accounting.	For commercial public sector entities that apply IFRS, there will be on-going consolidation issues (no convergence with IFRS in lessor accounting).	For commercial public sector entities that apply IFRS, there will be no consolidation issues (as there is convergence with IFRS in lessor accounting).	For public sector entities that apply IPSAS, the consolidation procedures are increasingly difficult because of the lack of mirror accounting.
Information asymmetry	Prevents asymmetrical information in public sector financial reporting when governments do not publish consolidated financial statements.	-	-	Creates asymmetrical information in public sector financial reporting when governments do not publish consolidated financial statements.

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Lessor—IPSAS 13, IFRS 16 and right-of-use model recognition requirements (including property and vehicle leases)

Question

1. Does the IPSASB agree with staff's analysis of IPSAS 13, IFRS 16 and the application of the right-of-use model to lessor accounting?

Detail

Introduction

2. At the June 2016 meeting the IPSASB **directed** staff to analyze the IPSAS 13 and IFRS 16 recognition and measurement requirements (including property and vehicle leases) and compare them with the right-of-use model in lessor accounting.
3. This agenda item is related to the previous Agenda Item 8.2.1.

IPSAS 13 accounting requirements

4. In IPSAS 13, *Leases*, a lease is classified as a finance lease or as an operating lease. The dual model in IPSAS 13 has the following accounting requirements:
 - (a) Finance lease—the underlying asset is derecognized in the lessor's financial statements and recognized in the lessee's financial statements and the lessor recognizes a lease receivable as the net investment on the lease.
 - (b) Operating lease—the lessor does not derecognize the underlying asset and recognizes revenue on either a straight-line basis or another systematic basis.
5. [Appendix A](#) below shows an illustrative example of application of IPSAS 13 to lessor accounting in a finance lease under IPSAS 13. [Appendix B](#) below shows an illustrative example of application of IPSAS 13 to lessor accounting in an operating lease under IPSAS 13.
6. The dual model in IPSAS 13 has two major consequences:
 - (a) The underlying asset may not be recognized in the lessee's and in the lessor's financial statements; and,
 - (b) The lessor may not recognize a lease receivable while the lessee may recognize the lease liability in the same lease contract.
7. These two consequences provides asymmetrical accounting results when both the lessee and the lessor are public sector entities and can distort the analysis of the public sector. They can also increase difficulty in consolidation procedures (see [Appendix C](#) of Agenda Item 8.2.1 for more details).

IFRS 16 accounting requirements

8. IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17, *Leases*. The IASB made changes in the following areas in IFRS 16:

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- (a) Definition of a lease;
- (b) Definition of initial direct costs;
- (c) Initial measurement of the lease payments includes contingent rents; and
- (d) Disclosures.

Right-of-use model

9. [Appendix C](#) shows an illustrative example of application of the right-of-use model to lessor accounting. The illustrative example shows how the adoption of the right-of-use model for lessor accounting would mirror lessee accounting, while being consistent with the grant of a right to the operator model in IPSAS 32.

Decision required

10. Does the IPSASB support adoption of the right-of-use model to lessor accounting or retention of the risks and rewards model in the new IPSAS on Leases?

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Appendix A—Illustrative example of lessor accounting for a finance lease under IPSAS 13

Assumptions:

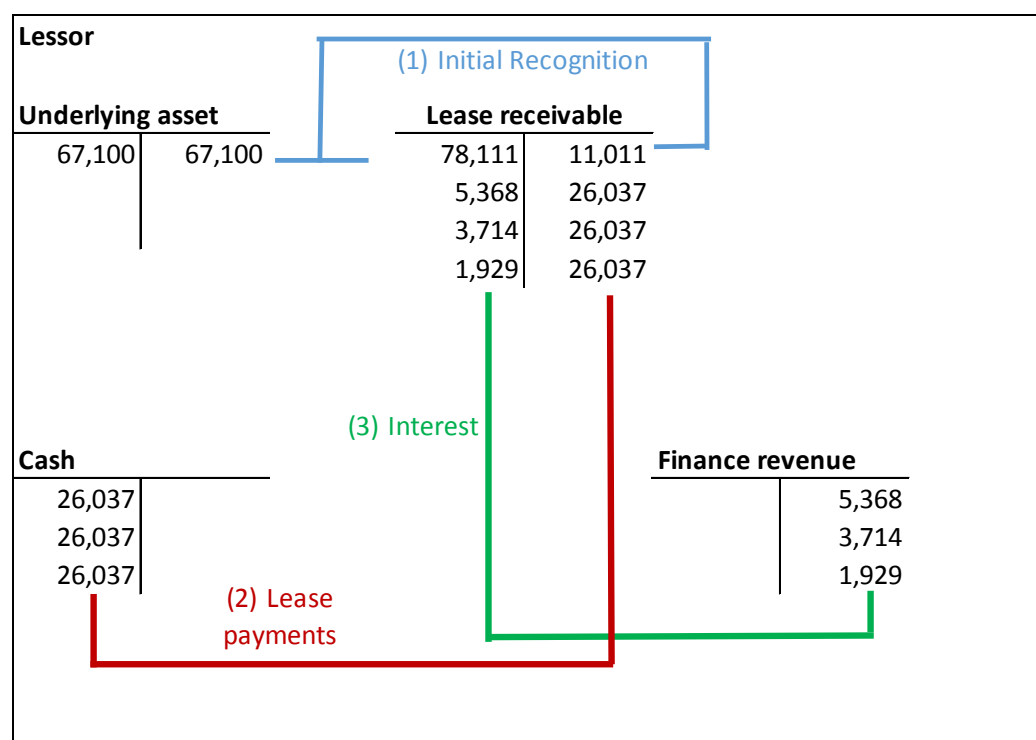
Value of the underlying asset: 67.100 CU

Total Payments: 78.111 CU

Interest rate: 8%

Lease term: 3 years

Finance Lease



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Appendix B—Illustrative example of lessor accounting for an operating lease under IPSAS 13

Assumptions:

Value of the underlying asset: 67.100 CU

Total payments: 78.111 CU

Lease term: 3 years

Finance Lease

Lessor			
Underlying asset		Depreciation	Cumulative Depreciation
67,100		6,710	6,710
		(2) Annual Depreciation	
Cash		Revenue	
26,037			26,037
26,037			26,037
26,037			26,037
(1) Lease payments			

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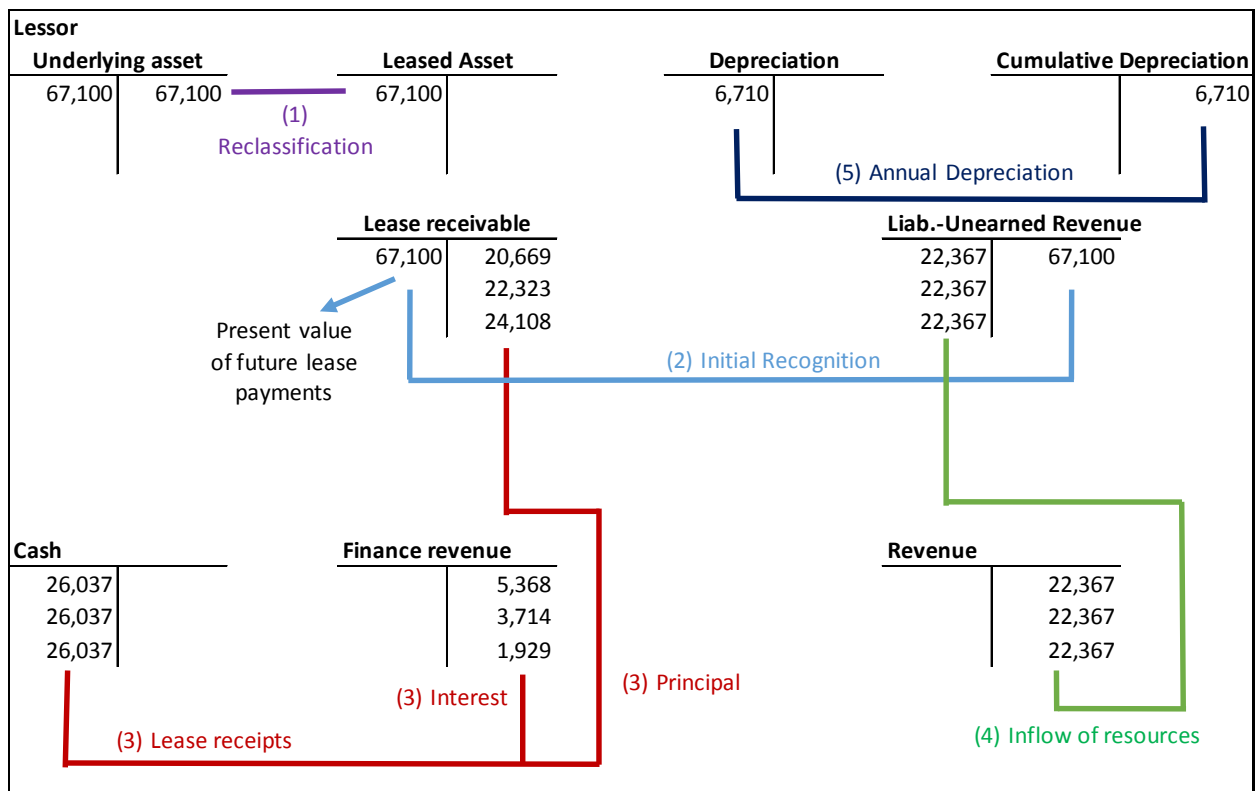
Appendix C—Illustrative example of lessor accounting under the right-of-use model

Assumptions:

Value of the underlying asset: 67.100 CU

Interest rate: 8%

Lease term: 3 years



Sale and leaseback transactions**Question**

1. Does the IPSASB agree with staff's analysis of sale and leaseback transactions?

Detail

2. IFRS 16 introduced additional requirements for the recognition of revenue related to sale and leaseback transactions. IFRS 16 now requires that a transfer of an asset is accounted for as a sale only if the transfer meets the requirements in IFRS 15, *Revenue from Contracts with Customers*. The IASB was of the view that 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."³²
3. IFRS 15 follows a performance obligation approach to recognize revenue from the transfer of goods and services to customers and is applicable to both lessee and lessor.
4. According to IFRS 16, if the transfer of the underlying asset satisfies the requirements of IFRS 15 to be accounted for as a sale, the transaction will be accounted for as a sale (the seller-lessee derecognizes the underlying asset and the buyer-lessor recognizes the underlying asset) and a lease by both the lessee and the lessor. If not, the transaction is accounted for as a financing by both the seller-lessee and the buyer-lessor and both apply IFRS 9, *Financial Instruments*.
5. Currently IPSASB's literature does not have a performance obligation approach for the recognition of revenue from the sale of assets. Staff has identified two options to manage this new requirement in IFRS 16 in the future development of the Leases project:
 - (a) Option 1—Do not include any requirement now and include the performance obligation approach later (as a consequential amendment of a new or revised IPSAS on Revenue); or
 - (b) Option 2—Include the current requirements in IPSAS 9 in a new IPSAS on Leases. If and when the IPSASB finalizes a new or revised IPSAS on Revenue, primarily drawn from IFRS 15, insert the performance obligation approach as a consequential amendment.
6. Option 1 maintains the current situation in IPSAS 13, *Leases* where there are no explicit requirements to assess whether the sale qualifies as a sale or not. Currently, preparers need to rely implicitly on IPSAS 9, *Revenue from Exchange Transactions* and IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* depending on whether the sale is an exchange or a non-exchange transaction.
7. Option 2 has the advantage of meeting the objective of IFRS 16 in ensuring that a sale in a sale and leaseback transaction is treated in the same way as the sale of other goods. However, it has the major disadvantage of creating instability in the new IPSAS on Leases because the requirements will be temporary.

³² Paragraph BC261 of IFRS 16

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Decision required

8. Does the IPSASB support the adoption of Option 1 or Option 2 in the Exposure Draft on Leases?

Leases that transfer ownership**Questions**

1. Does the IPSASB agree with staff's analysis of accounting for leases that transfer ownership?

Detail

2. The Task Based Group was of the view that the Leases project needs to clarify how leases that transfer ownership should be addressed, as many leases have stipulations about the transfer of ownership during or at the end of the lease term and do not contain termination options³³.
3. In IPSAS 13, *Leases*, a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.
4. The risks and rewards model in IPSAS 13 has the following accounting requirements:
 - (a) Finance lease—the underlying asset is derecognized from the lessor's financial statements and recognized in the lessee's financial statements and the lessor recognizes a lease receivable as the net investment on the lease.
 - (b) Operating lease—the lessor does not derecognize the underlying asset and recognizes revenue on either a straight-line basis or another systematic basis.
5. Staff notes that the introduction of the right-of-use model to lessor accounting implies that the previous classification of leases that existed in IPSAS 13 is no longer applicable to lessor accounting.
6. Staff is of the view that with the introduction of the right-of-use model to lessor accounting, an assessment needs to be made of whether the lease is, in fact, a financed sale of the underlying asset, i.e., a sale of goods with deferred payments.
7. The IASB considered in its Leases project "whether to include requirements in IFRS 16 to distinguish a lease from the sale or purchase of an asset"³⁴. The IASB decided not to provide requirements in IFRS 16 to distinguish a lease from a sale or purchase of an asset for the following reasons:
 - (a) "There was little support from stakeholders for including such requirements"³⁵;
 - (b) "The accounting for leases that are similar to the sale or purchase of the underlying asset would be similar to that for sales and purchases applying the respective requirements of IFRS 15 and IAS 16"³⁶; and

³³ Periods for which both the lessee and the lessor have an option to terminate the lease, or for which only the lessor has that option, are excluded from the lease term because they are considered as cancelable periods. Cancelable periods are excluded from the lease term.

³⁴ Paragraph BC138 of IFRS 16

³⁵ Paragraph BC139 of IFRS 16

³⁶ Paragraph BC139(a) of IFRS 16

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- (c) “The accounting for a transaction depends on the substance of that transaction and not its legal form. Consequently, if a contract grants rights that represent the in-substance purchase of an item of property, plant and equipment, those rights meet the definition of property, plant and equipment in IAS 16 and would be accounted for applying that Standard, regardless of whether legal title transfers. If the contract grants rights that do not represent the in-substance purchase of an item of property, plant and equipment but that meet the definition of a lease, the contract would be accounted for applying IFRS 16.”³⁷
 - (d) “IFRS 16 applies to contracts that convey the right to use an underlying asset for a period of time and does not apply to transactions that transfer control of the underlying asset to an entity—such transactions are sales or purchases within the scope of other Standards (for example, IFRS 15 or IAS 16)”.³⁸
8. Staff notes that IFRS 15, *Revenue from Contracts with Customers* follows a performance obligation approach to recognize revenue and IPSAS 9, *Revenue from Exchange Transactions* follows a risks and rewards approach to recognize revenue from sales of goods (which was similar to the risks and rewards model the previously existed in IPSAS 13, *Leases*).
 9. Staff is of the view that the Exposure Draft on Leases should not provide guidance on leases that transfer ownership as they are within the scope of IPSAS 17, *Property, Plant and Equipment* and of IPSAS 9.
 10. Staff’s proposal not to provide guidance on leases that transfer ownership in the Exposure Draft on Leases is consistent with IASB’s approach not to include requirements in IFRS 16 to distinguish a lease from the sale or purchase of an asset.
 11. However, staff notes that the IPSASB’s literature does not currently have a performance obligation approach to recognize revenue and it might be argued that the guidance in IPSAS 9 might not be sufficient or might lead to different conclusions if IFRS 15 was applied. This is likely to be a temporary situation, because the IPSASB is likely to develop an IPSAS based on IFRS 15 to replace IPSAS 9 and IPSAS 11, *Construction Contracts*.
 12. Staff also notes that according to paragraph 32 of IFRS 16 “If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term or if the cost of the right-of-use asset reflects that the lessee will exercise a purchase option, the lessee shall depreciate the right-of-use asset from the commencement date to the end of the *useful life* of the underlying asset. Otherwise, the lessee shall depreciate the right-of-use asset from the commencement date to the earlier of the end of the *useful life* of the right-of-use asset or the end of the lease term.”
 13. Staff notes that these are the only requirements in IFRS 16 lessee accounting on leases that transfer ownership.
 14. Staff did not identify a public sector specific reason that warrant departure from IFRS 16 in the subsequent measurement of the right-of-use asset in leases that transfer ownership.

³⁷ Paragraph BC139(b) of IFRS 16

³⁸ Paragraph BC140 of IFRS 16

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Decisions required

15. Does the IPSASB want to provide:
 - (a) Guidance on leases that transfer ownership in the Exposure Draft on Leases?
 - (b) Additional guidance on leases that transfer ownership in IPSAS 9?
 - (c) Retain the paragraph 32 of IFRS 16 in the Exposure Draft on Leases?

Lessee—Recognition exemptions—Threshold of leases for which the underlying asset is of low value**Question**

1. Does the IPSASB agree with the proposed draft Basis for Conclusions paragraphs on recognition exemptions, including the threshold for leases for which the underlying asset is of low value and whether recognition exemptions should be requirements or options?

Detail

2. At the June meeting the IPSASB **instructed** staff to draft paragraphs for the Basis for Conclusions of the Exposure Draft explaining the IPSASB's rationale for its position on the recognition exemptions to be approved at the September meeting.
3. The IPSASB Chair also instructed staff to engage with IPSASB members that had expressed a view on this issue in order to better capture the IPSASB's discussion and decision.
4. The following paragraphs are a result of these instructions.

*Basis for Conclusions to IPSAS xx, Leases**Recognition Exemptions*

1. The IPSASB considered the recognition exemptions in IFRS 16, *Leases*. The IPSASB did not identify a public sector specific reason that would warrant different recognition exemptions for public sector financial reporting purposes.
2. The IPSASB also considered whether the permissive recognition exemptions in IFRS 16 should be a requirement or an option in the new IPSAS on Leases. The IPSASB noted that, according to the IASB's research, leases of low value assets represent less than 1% of total non-current assets. In this context, the IPSASB considered that, on the one hand, making the recognition exemptions a requirement rather than an option would enhance comparability between public sector entities and provide increased cost relief to them. However, on the other hand, the IPSASB also noted that requiring recognition exemptions for short-term leases may create a new arbitrage point, where entities could design their lease contracts to achieve specific accounting outcomes.
3. On balance, the IPSASB concluded that there was no public sector specific reason to require rather than permit recognition exemptions. The IPSASB also considered that, by not requiring the application of the exemptions, public sector entities would be able to adopt an approach that best provides a faithful representation of leasing transactions in their statements of financial position.
4. The IPSASB noted that IFRS 16 does not set a specific monetary amount for leases of low-value assets. Instead, the IASB included in paragraph BC100 of the Basis for

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Conclusions: “the IASB had in mind leases of underlying assets with a value, when new, in the order of magnitude of US\$5,000 or less”. The IPSASB considered whether it was appropriate for public sector financial reporting to use the same or a different monetary amount, or not make any reference to a threshold in the Basis for Conclusions of IPSAS xx, *Leases*.

5. The IPSASB concluded that public sector entities should be free to set a threshold for leases of low-value assets in the context of materiality in relation to the faithful representation of leasing transactions in their statements of financial position, and that the IPSASB would not provide guidance on that monetary amount; setting a specific monetary amount might have the result of impairing the faithful representation of public sector financial reporting by individual entities.

Decision required

5. Does the IPSASB want to adopt the proposed Basis for Conclusions’ paragraphs on recognition exemptions, including threshold of leases for which the underlying asset is of low value in the Exposure Draft on Leases?

Leases in the public sector—Fact patterns³⁹

Fact pattern #1— Lease between public sector entities

1. The Department is prohibited by the Treasury to hold finance leases. The Department has several operating lease agreements for property, plant and equipment, where the lessors effectively retain all the risks and rewards incidental to ownership of the items leased. Equal instalments of lease payments are charged to the Statement of Comprehensive Income over the lease term, as this is representative of the pattern of benefits to be derived from the lease property.
2. Agencies are required to lease all their passenger vehicles from the Government vehicle fleet. Agencies are issued a monthly invoice, including a lease charge for all vehicles. The lease charge is based on the purchase price, the expected residual value and estimated lease term of the vehicle.

Fact pattern #2—Operating leases as lessor

3. A City owns a range of facilities that are available for lease by not-for-profit sport, recreational and community organizations. Generally, leases to not-for-profit organizations do not reflect commercial arrangements and have minimal lease payments.
4. Land and buildings which are leased under these arrangements are recognized within property, plant and equipment in the Statement of Financial Position, and associated rental income is recognized in accordance with the Council's revenue recognition policy.
5. The City also leases some of its land and buildings on commercial terms which may include incentives for the lessee to enter into the agreement, for example a rent-free period or discounted rent. In many instances the lessee provides all or some of the following: capital improvements, maintenance, day to day management, access to the public, and contribution back to the community.
6. The City discloses the subsidized component of the lease as grants with an estimate of its value.

Fact pattern #3—Centralized lessor

7. A Directorate-General within the Ministry of Finance of a country is responsible for buying, leasing, managing and selling property, plant and equipment to other public sector entities or to private sector entities. Some leases are classified as finance leases and others are classified as operating leases depending on whether the risks and rewards incidental to ownership have been transferred or not, respectively.
8. The Directorate-General also buys assets from other public sector entities or from private sector entities and afterwards leases them back to the same public sector entities. The lease payments are at market rates.
9. The Directorate-General works as a centralized lessor in order to maximize the efficiency of management of public sector assets. In the scenario, where the lessee only has right to use the underlying asset for a short period of time, the lessee is responsible for conservation and maintenance of the assets and related expenses. In other cases, the responsibility can be shared between the lessee and the lessor or can only belong to the lessor.

³⁹ These fact patterns are based on real life examples.

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10. The Directorate-General also leases entire buildings to a single entity or only units of a building to several public sector entities.

Lessor accounting—History of IASB’s project

Introduction

1. The IASB published three consultation documents in its project on Leases:
 - (a) [Leases—Preliminary Views](#) issued in March 2009—Only included “some of the issues that will need to be resolved in developing any proposed new standard for lessors”⁴⁰ without any preliminary views because “the IASB decided to defer consideration of lessor accounting and concentrate on developing an improved lessee accounting model”⁴¹;
 - (b) [Exposure Draft \(ED\)—Leases](#) issued in August 2010—Included proposals for lessor accounting because “Although many of the problems associated with existing lease standards relate to the treatment of operating leases in the financial statements of lessees, keeping the existing lease standards for lessors would be inconsistent with the proposed approach to lessee accounting. It would also be inconsistent with the boards’ proposed approach to revenue recognition, described in their exposure draft *Revenue from Contracts with Customers*”⁴².
 - (c) [Exposure Draft—Leases](#) issued in May 2013—Included proposals for lessor accounting because “Although many of the problems associated with existing leases requirements relate to the accounting for operating leases in the financial statements of lessees, retaining the existing lease accounting models for lessors would be inconsistent with the proposed approach to lessee accounting and would result in additional complexity in financial reporting. In addition, the boards decided that it would be beneficial to consider lessor accounting at the same time they are developing proposals on revenue recognition.”⁴³

Exposure Draft— Leases (2010)⁴⁴

2. According to paragraph 13 of [IASB/FASB Staff paper](#), “Nearly all of the respondents who commented on the boards’ decision to defer consideration of lessor accounting disagree with that decision. Those respondents stated that a leasing transaction involves two parties—lessor and lessee—and should be considered from both perspectives simultaneously to develop consistent and symmetrical accounting. They noted that most lessee and lessor accounting issues are interrelated. Consequently, evaluating only one side of a lease arrangement may not provide enough information to develop an improved standard.”
3. As a consequence, the 2010 ED proposed new accounting for lessors with two models:
 - (a) A performance obligation approach, where the lessor retains significant risks or benefits associated with the underlying asset; and

⁴⁰ Paragraph 10.1 of Leases—Preliminary Views

⁴¹ Paragraph 10.1 of Leases—Preliminary Views

⁴² Page 5 of Exposure Draft—Leases (ED/2010/9)

⁴³ Page 5 of Exposure Draft—Leases (ED/2013/6)

⁴⁴ The 2010 ED is a joint Exposure Draft between the IASB and the Financial Accounting Standards Board (FASB).

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- (b) A derecognition approach, where the lessor does not retain significant risks or benefits associated with the underlying asset.
4. In the first case, the lessor would recognize a lease receivable and a liability at the commencement date, and would also continue to recognize the underlying asset. In the second case, the lessor would derecognize the underlying asset, and recognize a lease receivable and any retained interest in the underlying asset (a 'residual asset') at the commencement date.
 5. According to the Basis for Conclusion of IFRS 16 many respondents disagreed with the proposals for lessor accounting because:
 - (a) "Some respondents were concerned that the dual accounting model proposed for lessors was not consistent with the single accounting model proposed for lessees.
 - (b) Many respondents opposed the performance obligation approach. In the view of those respondents, the approach would artificially inflate a lessor's assets and liabilities.
 - (c) Some respondents recommended applying the derecognition approach to all leases. However, many disagreed with the proposal to prevent a lessor from accounting for the effects of the time value of money on the residual asset.
 - (d) Some respondents thought that the lessor accounting requirements in IAS 17 Leases and FASB Topic 840 Leases work well in practice and supported retaining those requirements."⁴⁵
 6. According to paragraph 104 of [IASB/FASB Staff paper](#), "More than half of the respondents agreed with the derecognition approach to lessor accounting because they said it results in more relevant and understandable information to users than the alternative approach. Additionally, respondents argue that this approach is consistent with that in the revenue recognition project. Respondents added that the alternative approach of the recognition of a performance obligation by the lessor would result in double counting of assets on the statement of financial position."
 7. Having received this feedback, the IASB and the FASB "observed that it would not be possible to reflect the views of all stakeholders because stakeholders did not have a united view of the economics of leases."⁴⁶
 8. As a consequence, the IASB and the FASB published a second joint Exposure Draft—Leases on May 2013.

Exposure Draft— Leases (2013)

9. The 2013 Exposure Draft proposed a dual approach for the recognition and measurement of leases:
 - (a) "For leases for which the lessee was expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset, a lessor would recognise its residual interest in the underlying asset separately from its receivable from the lessee.
 - (b) For other leases, a lessor would recognise the underlying asset, i.e. apply requirements similar to those in IAS 17 for operating leases."⁴⁷

⁴⁵ Paragraph BC10(c) of IFRS 16

⁴⁶ Paragraph BC11 of IFRS 16

⁴⁷ Paragraph BC12(b) of IFRS 16

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10. The IASB classified the first type of leases as Type A and the second as Type B.
11. According to the Basis for Conclusion of IFRS 16 “the majority of stakeholders disagreed with the proposed lessor accounting model. Most of these stakeholders were of the view that the previous lessor accounting model in IAS 17 was not fundamentally flawed and should not be changed.”⁴⁸
12. As a consequence of this reaction, the IASB decided to retain the risks and rewards model that existed in IAS 17, *Leases*, in the new IFRS 16, *Leases*.

⁴⁸ Paragraph BC14(d) of IFRS 16