

Meeting: International Public Sector Accounting Standards Board

Meeting Location: Stellenbosch, South Africa

Meeting Date: December 6–9, 2016

From: João Fonseca

Agenda Item 9

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 | 9.1.1 |
| | Decisions up to June 2016 meeting | 9.1.2 |
| | Project roadmap | 9.1.3 |
| Decisions required at this meeting | Lessor—Analysis of lessor accounting models and approaches | 9.2.1 |
| | Lease—Measurement (including “peppercorn leases”) | 9.2.2 |
| | Lessee—Reassessment of the lease liability and lease modifications | 9.2.3 |
| | Sale and leaseback transactions—Draft section of core Standard and Basis for Conclusions | 9.2.4 |

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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:</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 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. | |
| September 2016 | <p>The IPSASB directed staff to:</p> <ul style="list-style-type: none"> • Draft text to be included in the core Standard on guidance about sales that are in the context of a sale and leaseback transaction, and a draft Basis for Conclusions on why the IPSASB took this decision. • Analyze further lessor accounting models against the criteria of consistency with the Conceptual Framework, internal consistency with IPSASB’s current literature, and consistency with lessee accounting taking into account the overall public sector context. | |

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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; |
| September 2016 | <ul style="list-style-type: none">• The IPSASB made a tentative decision not to include explicit guidance in an exposure draft on the assessment of a sale within the context of a sale and leaseback transaction based on a performance obligation approach, prior to any decision on, and development of, an IPSAS drawn from IFRS 15, <i>Revenue from Contracts with Customers</i>.• The IPSASB decided not to adopt the lessor accounting requirements in IFRS 16, <i>Leases</i>. |

LEASES PROJECT ROADMAP

| Meeting | | Objective: IPSASB to consider: |
|---------|-----------|--|
| 2016 | March | <ol style="list-style-type: none"> 1. Education Session on IFRS 16 2. First draft of Project Brief, <i>Leases</i> |
| | June | <ol style="list-style-type: none"> 1. Approval of Project Brief, <i>Leases</i> 2. Lessee—Applicability of IFRS 16 recognition and measurement requirements to public sector financial reporting 3. Lessee—"Peppercorn" leases (no decision taken) 4. Lessor—Applicability of IFRS 16 recognition requirements to public sector financial reporting |
| | September | <ol style="list-style-type: none"> 1. Lessor—Applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model) 2. Sale and leaseback transactions 3. Lessee—Recognition Exemptions—Threshold of leases for which the underlying asset is of low value |
| | December | <ol style="list-style-type: none"> 1. Lessor—Analysis of lessor accounting models 2. Lease—Measurement (including "peppercorn leases") 3. Lessee—Reassessment of the lease liability and lease modifications 4. Sale and leaseback transactions—Draft section of Basis for Conclusions |
| 2017 | March | <ol style="list-style-type: none"> 1. Objective, Scope and Definitions 2. Identifying a lease: Lease versus Service versus Service Concessions 3. "Peppercorn leases"—"Geography" in IPSASs literature 4. Terminology: Conceptual Framework 5. Application Guidance 6. Review of first draft ED |
| | June | <ol style="list-style-type: none"> 1. Presentation: lessee and lessor 2. Disclosures: lessee and lessor (including "peppercorn leases") 3. Review of draft ED 4. Effective date and transition 5. Approval of ED |
| | September | Exposure period |
| | December | |
| 2018 | March | <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 |

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| Meeting | | Objective: IPSASB to consider: |
|---------|-----------|---|
| | June | <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 Transactions4. Review of Responses: Terminology—Conceptual Framework |
| | September | <ol style="list-style-type: none">1. Review of draft IPSAS2. Approval of new IPSAS |

Lessor—Analysis of lessor accounting models and approaches**Questions**

1. Does the IPSASB agree with staff's analysis on approaches to the right-of-use model in lessor accounting?

Detail

2. At the September 2016 meeting, the IPSASB decided not to follow IFRS 16 lessor accounting and directed staff to analyze up to three lessor accounting models.
3. The Task Based Group (TBG) and staff decided to carry out a comparative analysis of the following three models:
 - (a) Grant of a right to use model (presented at the September 2016 IPSASB meeting);
 - (b) Risks and benefits model (IASB's 2010 Exposure Draft); and
 - (c) Consumption of economic benefits model (IASB's 2013 Exposure Draft).
4. The above three models were selected because IPSASB's literature already has a Standard that deals with granting rights over underlying assets (IPSAS 32, *Service Concession Arrangements: Grantor*), and the IASB published for consultation lessor accounting models that could possibly work for public sector financial reporting.
5. Staff notes that the IASB never proposed the grant of a right to use model in their exposure drafts because symmetry in lease accounting was never viewed as an objective for the joint IASB/FASB convergence project on leases.
6. The criteria to analyze the three lessor accounting models were the following:
 - (a) Consistency with other IPSASs;
 - (b) Consistency with Conceptual Framework;
 - (c) Consistency with lessee accounting model (IFRS convergence); and
 - (d) Public sector specific issues.
7. Staff notes that the above listing does not imply a hierarchy in selecting an appropriate model for public sector financial reporting.
8. Staff carried out an in-depth comparative analysis of the three lessor accounting models and discussed it with the TBG. The main conclusion of the TBG and staff is that the IASB's models were not consistent with the IPSASB's decision to adopt a symmetrical approach to lease accounting in the draft ED on Leases. The IASB's proposals apply different dual models with two approaches each.
9. Therefore, the IASB's models were not an appropriate comparison for the grant of a right to use model applied to lessor accounting, as presented at the September 2016 IPSASB meeting. [Appendix A](#) below provides a description of the economic rationale of the three models.

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10. The TBG and staff raised the possibility that the grant of a right to use model applied to lessor accounting itself could have two mutually exclusive approaches for initial recognition. These two mutually exclusive approaches are a result of different interpretations of the Conceptual Framework, and whether the grant of a right to the operator model in IPSAS 32 is applicable to lessor accounting.
11. [Appendix B](#) below provides an in-depth comparative analysis of the two mutually exclusive approaches for the right-of-use model using the same criteria identified in paragraph 6.
12. The main conclusions of the analysis are:
 - (a) Approach 1 favors the recognition of physical assets in its entirety, and Approach 2 recognizes physical assets as portions (rights); and
 - (b) Approach 1 involves the recognition of a liability related to unearned revenue, and Approach 2 involves the recognition of lease revenue representing the present value of the lease payments and lease expense representing the cost of the portion of the underlying asset that is derecognized at the date of commencement of the lease.

Decisions required

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

Appendix A—Economic rationale of IASB's models in the 2010 and 2013 Exposure Drafts and the grant of a right to use model

1. The economic rationale of the three lessor accounting models are the following:
 - (a) **Right-of-use model**—Leases are financings of the right to use an underlying asset;
 - (b) **Lessor's exposure to risks or benefits associated with the underlying asset**—Depending on the extent to which a lessor retains exposure to risks and benefits associated with the underlying asset:
 - (i) Performance obligation approach—The lessor retains exposure to significant risks or benefits associated with the underlying asset;
 - (ii) Derecognition approach—The lessor does not retain exposure to significant risks or benefits associated with the underlying asset.
 - (c) **Lessee's consumption of economic benefits embedded in the underlying asset and its nature**—Depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset and its nature:
 - (i) Type A—for leases of assets other than property, unless one of the following two criteria is met:
 - a. The lease term is for an insignificant part of the total *economic life* of the underlying asset; or
 - b. The present value of the *lease payments* is insignificant relative to the fair value.

If either criterion above is met, the lease is classified as a Type B lease.
 - (ii) Type B—for leases of property, unless one of the following two criteria is met:
 - a. The lease term is for the major part of the remaining economic life of the underlying asset; or
 - b. The present value of the lease payments accounts for substantially all of the fair value of the underlying asset at the commencement date.

If either criterion above is met, the lease is classified as a Type A lease. Notwithstanding the requirements above, a lease is classified as a Type A lease if a lessee has a significant economic incentive to exercise an option to purchase the underlying asset.
2. The right-of-use model is a single model, and the IASB's models are dual models.

Appendix B—Comparative analysis of two approaches to the right-of-use model in lessor accounting

Introduction

1. This Agenda Item is divided into the following sections:
 - (a) Economic rationale;
 - (b) Initial recognition in the statement of financial position and revenue/expense recognition;
 - (c) Comparative analysis:
 - (i) Consistency with IPSAS 32, *Service Concession Arrangements: Grantor*;
 - (ii) Consistency with Conceptual Framework;
 - (iii) Consistency with lessee accounting (IFRS convergence); and
 - (iv) Public sector specific issues.
 - (d) Public interest considerations

Economic Rationale

2. In the right-of-use model, leases are financings of the right to use an underlying asset. The lessor grants the right to use an underlying asset to the lessee in exchange for consideration.
3. Based on this economic rationale, the TBG and staff have identified two approaches¹ for initial recognition in lessor accounts based on whether:
 - (a) Physical assets are assets recognized/derecognized as a whole (Approach 1) as opposed to recognize/derecognize as portions of assets (rights) (Approach 2); and
 - (b) The economic nature of the credit entry implies the recognition of a liability (unearned revenue) (Approach 1) as opposed to not recognizing a liability (unearned revenue) (Approach 2).

Initial recognition in the statement of financial position and revenue/expense recognition

4. The main characteristics of the two approaches are in the following table:

¹ Approaches 1 and 2 are similar to the performance obligation and derecognition approach, respectively, in the IASB's 2010 ED. To access the IASB's 2010 ED, please click [here](#).

[Agenda Item 8.2.1](#) of the September 2016 IPSASB meeting provides IASB's constituents concerns with IASB's proposals¹⁸ and staff's comments.

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Table 1—Summary of approaches to right-of-use model in lessor accounting

| Items | Approach 1 | Approach 2 |
|--|--|--|
| Statement of financial position (initial recognition) | | |
| Underlying asset | Continues to recognize the underlying asset | <ul style="list-style-type: none"> Derecognizes the portion of the carrying amount of the underlying asset that represents the lessee's right to use the underlying asset during the term of the lease. Reclassifies as a <i>residual asset</i> the remaining portion of the carrying amount of the underlying asset that represents the rights in the underlying asset that the lessor retains. |
| Lease receivable | Recognizes a lease receivable | |
| Liability (unearned revenue) | Recognizes a liability (unearned revenue) | Does not recognize a liability (unearned revenue) |
| Statement of financial performance | | |
| Revenue | <ul style="list-style-type: none"> Interest revenue on the right to receive lease payments Lease revenue as the liability is satisfied | <ul style="list-style-type: none"> Interest revenue on the right to receive lease payments Lease revenue representing the present value of the lease payments |
| Expense | <ul style="list-style-type: none"> N/A | <ul style="list-style-type: none"> Lease expense representing the cost of the portion of the underlying asset that is derecognized at the date of commencement of the lease |

Comparative analysis

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

5. IPSAS 32 has the following characteristics:
 - (a) Grants rights to use the underlying asset (right to access/operate);
 - (b) Follows a control based approach to identify the underlying asset; and
 - (c) Mirrors IFRIC 12, *Service Concession Arrangements*.
6. In the Grant of a Right to the Operator Model of IPSAS 32, the grantor grants the operator the right to earn revenue from third-party users.
7. IPSAS 32.9 states that:

“The grantor shall recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:

 - (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.”
8. IPSAS 32 provides an assessment of control of the underlying asset in two ways:
 - (a) Control of the use of the underlying asset (IPSAS 32.9(a)), and

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- (b) Control of significant residual interest in the underlying asset (IPSAS 32.9(b)).
9. IPSAS 32 is the mirror Standard of IFRIC 12, *Service Concession Arrangements* issued by the IASB.
 10. IFRIC 12 also follows a control-based approach to identify and recognize the underlying asset. Paragraph 5 of IFRIC 12 is the equivalent of paragraph 9 of IPSAS 32.
 11. 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 asset²; and,
 - (b) Other revenues not related to paragraph (a)³.
 12. In both cases, the grantor recognizes the unearned revenue as a liability until the conditions for revenue recognition are met⁴. 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 asset⁵.

Discussion on approaches to lessor accounting

13. The TBG and staff have identified arguments to recognize/derecognize physical assets as a whole (Approach 1), or recognize/derecognize assets as portions (rights) (Approach 2) by applying the IPSAS 32 control criteria.
14. The following table provides the arguments in favor of both approaches:

Table 2 – Arguments in favor of approaches 1 and 2 of the grant of a right to use model

| | Approach 1 | Approach 2 |
|--|---|--|
| Underlying asset | | |
| IPSAS 32.9(a) and IPSAS 32.9(b) | <ul style="list-style-type: none"> Both sub-paragraphs of IPSAS 32.9 needs to be taken together in order to assess the existence and transfer of control of an underlying asset. This means that if the grantor transfers only some rights related to the use of the underlying asset for a period of time, then the grantor is not transferring the control of the underlying asset because the lessor/grantor still has significant residual interest in the asset at the end of the arrangement. On the other hand, an entity is not transferring the control of the underlying asset if it only transfers the ownership (legal title) of the underlying asset. | <ul style="list-style-type: none"> Service concessions are different from leases because in service concessions the grantor retains control over the use of the infrastructure, by controlling or regulating what services the operator must provide, to whom it must provide them, and at what price (IPSAS 32.9(a)), and in leases the lessor transfers the right to use an underlying asset. |

² Paragraphs 24-26 of IPSAS 32

³ IPSAS 32.30

⁴ See IPSAS 32.AG47 and IPSAS 32.57 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

⁵ See IPSAS 32.AG47 and IPSAS 32.56 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

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| | Approach 1 | Approach 2 |
|-------------------------------------|---|--|
| IPSAS 32.9(b) | <ul style="list-style-type: none"> Is applied to leases where the lessor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement⁶. | <ul style="list-style-type: none"> A lessor does not necessary retain significant residual interest throughout the period of the arrangement. |
| Role of the operator | <ul style="list-style-type: none"> In a service concession where the operator has a demand risk it recognizes an intangible asset. The same happens in a lease where the lessee has the demand risk and recognizes a right-of-use asset. | <ul style="list-style-type: none"> Operator provides public services related to the service concession asset on behalf of the grantor, and in a lease the lessee does not act on behalf of the lessor. |
| Liability (unearned revenue) | | |
| Grantor/lessor obligations | <ul style="list-style-type: none"> In a service concession and in a lease, the grantor/lessor has the obligation to provide the operator with access to the underlying asset. Therefore, any payments received from the lessee not earned in the accounting period should be recognized as a liability until the conditions for revenue recognition are met, just like in service concessions. If the lessor does not provide the operator with access to the underlying asset during the lease term, then it would need to derecognize the portion of the lease receivable that it would no longer earn. This derecognition could be considered as an outflow of future economic benefits from the lessor to the lessee. | <ul style="list-style-type: none"> An obligation to permit the lessee access to the underlying asset is not a liability because there would appear to be no expected outflow of future economic benefits from the lessor, which is an essential component of the definition of a liability. |

15. The key decision is whether the criterion in IPSAS 32.9 to recognize/derecognize an underlying asset and recognize a liability (unearned revenue) is applicable to the right-of-use model in lessor accounting.

Conceptual Framework

16. Chapter 5 of the Conceptual Framework discusses assets, and Chapter 6 of the Conceptual Framework sets out the criteria for the recognition/derecognition of assets.
17. Paragraph 5.7 of the Conceptual Framework states that:

“A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity’s rights to a variety of benefits including, for example, the right to:

- Use the resource to provide services;

⁶ IFRS 16.BC118 and IFRS 16.BC140 clarify that in a lease the lessor continues to control the underlying asset, and does not convey the ownership of the underlying asset,

IFRS 16.BC118 states that: “IFRS 16 clarifies that only the economic benefits arising from use of an asset, rather than the economic benefits arising from ownership of that asset, should be considered when assessing whether a customer has the right to obtain the benefits from use of an asset. A lease does not convey ownership of an underlying asset; it conveys only the right to use that underlying asset.”

IFRS 16.BC140 states that: “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).”

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- Use an external party's resources to provide services, for example, leases;
- Convert the resource into cash through its disposal;
- Benefit from the resource's appreciation in value; or
- Receive a stream of cash flows."

18. Paragraph 5.11 and 5.12 of the Conceptual Framework states the following:

"5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision."

19. According to paragraph 6.2 of the Conceptual Framework, the recognition criteria are:

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

20. Paragraph 6.10 of the Conceptual Framework states that:

"Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred. In evaluating uncertainty about the existence of an element the same criteria are used for derecognition as at initial recognition."

21. Historical cost is one measurement basis for assets identified in the Conceptual Framework (see paragraphs 7.13-7.23). Historical cost provides information about the cost of services⁷, operational capacity⁸ and financial capacity⁹.

22. Regarding the issue on whether the unearned revenue is as a liability, the Conceptual Framework does not identify other obligations and other resources as elements. Paragraphs BC5.55 and B.56

⁷ Paragraph 7.16 of the Conceptual Framework

⁸ Paragraph 7.17 of the Conceptual Framework

⁹ Paragraph 7.18 of the Conceptual Framework

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explain 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”.

Discussion on approaches to lessor accounting

23. The TBG and staff have identified arguments to recognize/derecognize physical assets as a whole (Approach 1), and recognize/derecognize assets as portions (rights) (Approach 2) by applying the Conceptual Framework.
24. The following table provides the arguments in favor of both approaches:

Table 3 – Arguments in favor of approaches 1 and 2 of the grant of a right to use model

| | Approach 1 | Approach 2 |
|-------------------------|--|--|
| Underlying asset | | |
| Historical cost | <ul style="list-style-type: none"> • A lease does not negate the historical cost of the underlying asset; • 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. • 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. • The historical cost of the underlying asset provides information on the amount that may be used as effective security for borrowings even when assets are being leased out, which is relevant to an assessment of financial capacity. • The historical cost of the underlying asset provides information on the resources available to provide services in future periods although they are being provided by a third party—the lessee. This is relevant to an assessment of operational capacity. • In IPSAS 32, in the case when the operator does not pay the full amount in cash of the right to charge users, the grantor also recognizes a receivable for granting the right to charge users, and does not derecognize portions of the underlying asset. | <ul style="list-style-type: none"> • Historical cost overstates the assets because the same economic benefit (e.g., future cash flows from providing the right of use of the underlying asset) is represented twice in the statement of financial position: as a part of the historical cost of the asset, and as a lease receivable at the same time. • The statement of financial position should only recognize an asset for the amount to the rights retained in the underlying asset. |

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| | Approach 1 | Approach 2 |
|---|---|--|
| Measurement versus Partial derecognition | <ul style="list-style-type: none"> A measurement approach to the underlying asset does not imply the recognition of a separate residual asset representing the rights retained in the underlying asset. A measurement approach may affect depreciation and impairment of the underlying asset. | <ul style="list-style-type: none"> The lessor should derecognize the portion of rights in the underlying asset that were transferred to the lessee. The lessor should recognize only the rights retained in the underlying asset, as the lessee only recognizes the rights controlled in the right-of-use asset. |
| Physical assets as a whole versus a bundle of rights | <ul style="list-style-type: none"> Physical assets are recognized as a whole, and not as a bundle of rights. Physical assets cannot be transformed into "slices" of rights. | <ul style="list-style-type: none"> Physical assets are recognized as a bundle of rights that can be sold individually. Physical assets can be transformed into "slices" of rights |
| Unearned revenue | | |
| Liability versus not a liability related to unearned revenue | <ul style="list-style-type: none"> The grantor/lessor has a performance obligation to provide the operator with access to the underlying asset during the service concession/lease term. This performance obligation can be considered as a present obligation because if the grantor/lessor does not provide the operator/lessee with access to the underlying asset, then it would need to derecognize the portion of the lease receivable that it would no longer earn. This derecognition could be considered as an outflow of future economic benefits from the lessor to the lessee. | <ul style="list-style-type: none"> There would appear to be no expected outflow of future economic benefits from the lessor, which is an essential component of the definition of a liability. |

25. The IPSASB will need to decide whether the recognition or derecognition of portions of physical assets and recognition of a liability for unearned revenue is in accordance with the Conceptual Framework.

Consistency with lessee accounting (IFRS convergence)

26. Both approaches discussed above are broadly consistent with the right-of use model for lessee accounting because:
- The lessee recognizes a right-of-use asset representing the right to control the use of the underlying asset and a lease liability representing the present value of future lease payments;
 - In Approach 1, the lessor continues to recognize the underlying asset because the conditions for derecognition of the whole underlying asset are not met, a lease receivable representing the present value of future lease payments by the lessee, and a lease liability representing the unearned revenue in the lease.
 - In Approach 2, the lessor recognizes a residual asset representing the rights retained in the underlying asset because the rights over physical assets can be derecognized individually, and a lease receivable representing the present value of future lease payments by the lessee.
27. It can be argued that Approach 1 identifies the entity, which controls the underlying asset, but not the individual rights that are retained in the underlying asset. On the other hand, Approach 2 identifies the rights controlled by the lessor, but not which entity controls the underlying asset (see paragraphs 28 and 29 below).

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Public sector specific issues

28. Staff has identified the following public sector specific issues related to Approaches 1 and 2 that the IPSASB needs to consider:
- (a) While in Approach 1 the users of GPFRs will have information on physical assets according to who controls them in the lessor's accounts, in Approach 2 the users of GPFRs will have information on the control of individual rights over physical assets;
 - (b) While in Approach 1 the users of GPFRs will have information on physical assets in their entirety in lessor's accounts, in Approach 2 the users of GPFRs will have information on the control of individual rights over physical assets;
 - (c) While in Approach 1 the lessor is accountable for the physical asset in its entirety, in Approach 2 the lessor is only accountable for the rights retained in the underlying asset.
29. As leasing transactions are a decision of the management of the public sector entity, the IPSASB will need to consider which approach best meets the objectives of public sector financial reporting of accountability and decision-making.

Public interest considerations

30. It can be argued that in Approach 1 the public interest would be better met because physical assets would not be "transformed" into "slices" of individual controlled rights. However, it can also be argued that in Approach 2 the public interest would be better met because only the individual rights over physical assets that the lessor controls would be reflected in the financial statements
31. Staff is of the view that disaggregating physical assets into "slices" of individually controlled rights might impair the understandability of leasing transactions because physical assets would be treated like any other rights.
32. Staff is also of the view that derecognizing portions of physical assets might impair the faithful representation of leasing transactions because leases are also viewed as means of earning income from managing assets—the management has always an option to sell or to use the asset in its own operations.
33. The "dematerialization" of physical assets could also lead to losing the notion of control of the whole physical asset so that no entity is accountable for the physical asset in its entirety.
34. In conclusion, staff has reservations whether treating physical assets as portions or slices of rights meets the objectives of public sector financial reporting.

Lease—Measurement (including “peppercorn leases”)**Question**

1. Does the IPSASB agree with staff’s analysis of the measurement of leases (including “peppercorn leases”)?

Detail

2. IFRS 16, *Leases*, requires a cost measurement basis to measure the right-of-use asset and lease liability in the lessee’s accounts, with cost measured by reference to the present value of the lease payments. However, in the public sector quite often there are leases for zero or for a nominal amount (for example, one euro/dollar per month or per year). There are also cases where the lease payments are below market values, but are not nominal amounts.
3. All three cases above have one thing in common: the lease contains a subsidized component that reflects the fact that the lease payments are below market value. In these cases, the lease is considered a non-exchange transaction, where the lessee receives value from the lessor entity without directly giving approximately equal value in exchange.
4. Staff has identified three issues related to this Agenda Item:
 - (a) Replace the term “peppercorn leases” with the term concessionary leases;
 - (b) Measurement basis of leases; and
 - (c) Accounting of the subsidized component in concessionary leases.

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

5. Until now, the IPSASB has been using the term “peppercorn leases” to identify leases with a subsidized component. Staff notes that “peppercorn leases” share one common feature with concessionary loans: both are financing transactions with a non-exchange element.
6. On the other hand, staff has been aware that the term “peppercorn lease” is not a term used in other languages, and this might create translation problems.
7. Staff notes that there are some concessionary leases that involve no consideration and, therefore, the repayment obligation does not exist like in a concessionary loan. There are also other types of concessionary leases where the repayment obligation is only for a nominal amount so that, in substance, there is no repayment obligation.
8. If the term concessionary lease is applicable to all types of concessionary leases, then the term “concessionary” would have a broader meaning than that used in the application guidance on concessionary loans in IPSAS 29, *Financial Instruments: Recognition and Measurement* (see paragraph 17 below).
9. The IPSASB will need to consider whether in the term concessionary lease can apply to the arrangements noted in paragraph 7.

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10. Nevertheless, staff recommends the IPSASB to use the term concessionary leases for consistency with the term concessionary loans that is already used in IPSASB's literature, and in order to facilitate translation.

Measurement bases of leases

11. IFRS 16, *Leases*, requires that the lessee measures the right of use asset at cost. Cost does not appropriately reflect the economics of a concessionary lease. Therefore the IPSASB needs to consider the use of fair value as a measurement basis for such leases. However, a TBG member suggested that measuring the concessionary lease at cost and providing disclosures could be an alternative option where it is difficult to determine the fair value of a concessionary lease.
12. As the IPSASB decided not to follow IFRS 16 requirements for lessor accounting, the IPSASB will also need to consider the measurement basis of leases for lessors.
13. The TBG and staff have identified three possible options to measure leases, including concessionary leases for lessees and lessors:
- (a) Option 1—Measure all leases at fair value regardless of whether they are concessionary;
 - (b) Option 2—Measure leases that are exchange transactions at cost and measure concessionary leases (non-exchange transaction) at fair value; and
 - (c) Option 3—Measure concessionary leases at cost and provide disclosures.
14. Staff has identified the following advantages and disadvantages of each option:

Table 3 – Advantages and disadvantages of leases measurement options

| Criteria | Advantages | Disadvantages |
|-----------------|--|--|
| Option 1 | <ul style="list-style-type: none"> Consistency—because all leases would have a single measurement basis; Lessee's lease liability and lessor's lease receivable—Comparability with IPSAS 29 because of the similar measurement basis as other financial assets and financial liabilities¹⁰. | <ul style="list-style-type: none"> Cost implications—because fair value would need to be determined for all leases; Divergence with IFRS 16. |

¹⁰ According to paragraph 45 of IPSAS 29, *Financial Instruments: Recognition and Measurement*, a financial asset or financial liability is recognized initially "at its fair value plus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability."

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| Criteria | Advantages | Disadvantages |
|-----------------|---|--|
| Option 2 | <ul style="list-style-type: none"> Consistent with IPSAS 17, <i>Property, Plant and Equipment</i>¹¹ and IPSAS 31, <i>Intangible Assets</i>¹² that distinguishes acquisitions through an exchange transaction from a non-exchange transaction; Convergence with IFRS 16 for leases that are exchange transactions. | <ul style="list-style-type: none"> Finding the boundary between exchange and non-exchange may be difficult in practice in leases that are below market value, but have significant consideration. |
| Option 3 | <ul style="list-style-type: none"> Addresses the difficulty about measuring the fair value of a concessionary lease. | <ul style="list-style-type: none"> Disclosures are not a substitute for recognition of an element (subsidized component). |

15. The IPSASB will need to decide which option is appropriate for public sector financial reporting.

Accounting of the subsidized component in concessionary leases

16. As stated in paragraph 3 above, concessionary leases share one common feature with concessionary loans: both are non-exchange transactions. The IPSASB's literature already provides guidance on how to account for concessionary loans.
17. The guidance on how to account for the subsidized component of concessionary loans from the recipient side is in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, and from the transferor side is in IPSAS 29, *Financial Instruments: Recognition and Measurement*.
18. IPSAS 23.105B states that:

"Where an entity determines that the difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition is non-exchange revenue, an entity recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred assets by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized."

19. IPSAS 29.AG89 states the following:

"Any difference between the fair value of the loan and the transaction price (loan proceeds) is treated as follows:

- Where the loan is received by an entity, the difference is accounted for in accordance with IPSAS 23.
- Where the loan is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the loan is a transaction

¹¹ According to paragraphs 26 and 27 of IPSAS 17, "An item of property, plant, and equipment that qualifies for recognition as an asset shall be measured at its cost. Where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition."

¹² According to paragraph 31 of IPSAS 31, "An intangible asset shall be measured initially at cost in accordance with paragraphs 32–43. Where an intangible asset is acquired through a non-exchange transaction, its initial cost at the date of acquisition, shall be measured at its fair value as at that date."

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with owners, in their capacity as owners. Where the loan is a transaction with owners in their capacity as owners, for example, where a controlling entity provides a concessionary loan to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.”

20. A TBG member suggested the possibility of considering the subsidized portion as a deferred expense based on IPSAS 29.AG82 as follows:

“The fair value of a financial instrument on initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG108). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG106–AG112). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue unless it qualifies for recognition as some other type of asset.”

21. Staff is of the view that IPSAS 29.AG82 is not applicable to concessionary leases for the following reasons:
- (a) IPSAS 29.AG82 is applicable, for example, to credit impaired loans at its origination, and not to concessionary loans. For example, the creditworthiness of a financial instrument is below its transaction price. The section on concessionary loans starts at IPSAS 29.AG84;
 - (b) IPSAS 29.AG82 is applicable to other types of assets specified in the Standards. This means that in the context of concessionary loans there is an asset if it is considered as a capital contribution from owners (see IPSAS 29.AG89(b)); and
 - (c) The IPSASB's Conceptual Framework does not identify deferred expenses as elements.
22. Another TBG member raised the possibility of considering the granting of a concessionary lease as an impairment trigger for the underlying asset because the lessor might not obtain the same economic benefits from the asset as by using it in its own operations, or selling it. This could be the case where the lease is at no cost or for a nominal amount (for example, for one dollar/euro per month or per year).
23. The IPSASB will need to decide whether the current guidance on concessionary loans is applicable to concessionary leases.

Decision required

24. Does the IPSASB want to:
- (a) Replace the term “peppercorn leases” with the term “concessionary leases”?

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- (b) Measure all leases at fair value (Option 1), measure leases that are exchange transactions at cost and measure “peppercorn leases” (non-exchange transactions) at fair value (Option 2), or measure concessionary leases at cost and provide disclosure (Option 3) in the Exposure Draft on Leases?
- (c) Apply the current accounting treatment for the subsidized component of concessionary loans to concessionary leases?

Lessee—Reassessment of the lease liability, lease modifications separating components of a contract and lease term**Questions**

1. Does the IPSASB agree with staff's analysis on reassessment of the lease liability, lease modifications and separating components of a contract (lessee side), and lease term?

Detail

2. IFRS 16, *Leases*, includes requirements for lessees on reassessment of the lease liability and lease modifications.
3. [Appendix A](#) below provides draft sections of the Exposure Draft (ED) XX, *Leases* (marked-up from IFRS 16) on reassessment of the lease liability and lease modifications.
4. Staff did not identify a public sector specific reason not to apply the IFRS 16 requirements on reassessment of the lease liability and lease modifications in the ED.
5. Staff notes that these sections refer to a lease as a contract. Staff also notes that this wording might be revised at a later stage of the project when discussing the definitions section of the ED because in the public sector leases there may be binding arrangements that do not take the form of legal contracts. Staff expects this issue to be discussed at the March 2017 IPSASB meeting.
6. As can be seen through the draft sections of the ED on reassessment of the lease liability and lease modifications, there are links to other parts of IFRS 16, namely: (i) separating components of a contract from the lessee side¹³, and (ii) lease term.
7. [Appendix A](#) below also provides draft sections of the Exposure Draft XX, *Leases* (marked-up from IFRS 16) on these issues.
8. Staff did not identify a public sector specific reason not to apply the IFRS 16 requirements on separating components of a contract (from the lessee side) and lease term.

Decisions required

9. In the ED does the IPSASB want to adopt the IFRS 16 requirements on:
 - (a) Reassessment of the lease liability, lease modifications and separating components of a contract from the lessee side?
 - (b) Lease term?

¹³ Staff does not address the issue of separating components of a contract from the lessor side because the lessor accounting model is still under discussion.

Appendix A—Exposure Draft Sections on: (i) Lessee—Reassessment of the lease liability, lease modifications, and separating components of a contract; (ii) and Lease Term

EXPOSURE DRAFT XX, *LEASES* (marked-up¹⁴ from IFRS 16, *Leases*)

Separating components of a contract

- 12 For a contract that is, or contains, a lease, an entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract, unless the entity applies the practical expedient in paragraph 15. Paragraphs B32–B33 set out guidance on separating components of a contract.

Lessee

- 13 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
- 14 The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximizing the use of observable information.
- 15 As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph 12 of IPSAS 29, *Financial Instruments: Recognition and Measurement*.
- 16 Unless the practical expedient in paragraph 15 is applied, a lessee shall account for non-lease components applying other applicable Standards.

...

Lease term

- 18 An entity shall determine the lease term as the non-cancellable period of a lease, together with both:
- (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and

¹⁴ The text is not marked-up for amendments related to North American English or IPSASB's editorial style. The paragraph numbering of IFRS 16 is retained in this Appendix only to facilitate the cross-referencing. In the Exposure Draft XX, *Leases* the paragraph numbering will be updated.

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- (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
- 19 In assessing whether a lessee is reasonably certain to exercise an option to extend a lease, or not to exercise an option to terminate a lease, an entity shall consider all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option to extend the lease, or not to exercise the option to terminate the lease, as described in paragraphs B37–B40.
- 20 A lessee shall reassess whether it is reasonably certain to exercise an extension option, or not to exercise a termination option, upon the occurrence of either a significant event or a significant change in circumstances that:
- (a) Is within the control of the lessee; and
 - (b) Affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term (as described in paragraph B41).
- 21 An entity shall revise the lease term if there is a change in the non-cancellable period of a lease. For example, the non-cancellable period of a lease will change if:
- (a) The lessee exercises an option not previously included in the entity's determination of the lease term;
 - (b) The lessee does not exercise an option previously included in the entity's determination of the lease term;
 - (c) An event occurs that contractually obliges the lessee to exercise an option not previously included in the entity's determination of the lease term; or
 - (d) An event occurs that contractually prohibits the lessee from exercising an option previously included in the entity's determination of the lease term.

Lessee

Recognition

...

Measurement

Initial measurement

Initial measurement of the right-of-use asset

...

Initial measurement of the lease liability

...

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Subsequent measurement

Subsequent measurement of the right-of-use asset

...

Cost model

...

Other measurement models

Subsequent measurement of the lease liability

...

Reassessment of the lease liability

- 39 After the commencement date, a lessee shall apply paragraphs 40–43 to remeasure the lease liability to reflect changes to the lease payments. A lessee shall recognize the amount of the remeasurement of the lease liability as an adjustment to the right-of-use asset. However, if the carrying amount of the right-of-use asset is reduced to zero and there is a further reduction in the measurement of the lease liability, a lessee shall recognize any remaining amount of the remeasurement in surplus or deficit.
- 40 A lessee shall remeasure the lease liability by discounting the revised lease payments using a revised discount rate, if either:
- (a) There is a change in the lease term, as described in paragraphs 20–21. A lessee shall determine the revised lease payments on the basis of the revised lease term; or
 - (b) There is a change in the assessment of an option to purchase the underlying asset, assessed considering the events and circumstances described in paragraphs 20–21 in the context of a purchase option. A lessee shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.
- 41 In applying paragraph 40, a lessee shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the date of reassessment, if the interest rate implicit in the lease cannot be readily determined.
- 42 A lessee shall remeasure the lease liability by discounting the revised lease payments, if either:
- (a) There is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee.
 - (b) There is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in

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market rental rates following a market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (i.e., when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.

- 43 In applying paragraph 42, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.

Lease modifications

- 44 A lessee shall account for a lease modification as a separate lease if both:
- (a) The modification increases the scope of the lease by adding the right to use one or more underlying assets; and
 - (b) The consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope and any appropriate adjustments to that stand-alone price to reflect the circumstances of the particular contract.
- 45 For a lease modification that is not accounted for as a separate lease, at the *effective date of the lease modification* a lessee shall:
- (a) Allocate the consideration in the modified contract applying paragraphs 13–16;
 - (b) Determine the lease term of the modified lease applying paragraphs 18–19; and
 - (c) Remeasure the lease liability by discounting the revised lease payments using a revised discount rate. The revised discount rate is determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
- 46 For a lease modification that is not accounted for as a separate lease, the lessee shall account for the remeasurement of the lease liability by:
- (a) Decreasing the carrying amount of the right-of-use asset to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessee shall recognize in surplus or deficit any gain or loss relating to the partial or full termination of the lease.
 - (b) Making a corresponding adjustment to the right-of-use asset for all other lease modifications.

APPLICATION GUIDANCE**Separating components of a contract (paragraphs 12–17)**

- B32 The right to use an underlying asset is a separate lease component if both:
- (a) The lessee can benefit from use of the underlying asset either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other suppliers) or resources that the lessee has already obtained (from the lessor or from other transactions or events); and
 - (b) The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract. For example, the fact that a lessee could decide not to lease the underlying asset without significantly affecting its rights to use other underlying assets in the contract might indicate that the underlying asset is not highly dependent on, or highly interrelated with, those other underlying assets.
- B33 A contract may include an amount payable by the lessee for activities and costs that do not transfer a good or service to the lessee. For example, a lessor may include in the total amount payable a charge for administrative tasks, or other costs it incurs associated with the lease, that do not transfer a good or service to the lessee. Such amounts payable do not give rise to a separate component of the contract, but are considered to be part of the total consideration that is allocated to the separately identified components of the contract.

Lease term (paragraphs 18–21)

- B34 In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.
- B35 If only a lessee has the right to terminate a lease, that right is considered to be an option to terminate the lease available to the lessee that an entity considers when determining the lease term. If only a lessor has the right to terminate a lease, the non-cancellable period of the lease includes the period covered by the option to terminate the lease.
- B36 The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.
- B37 At the commencement date, an entity assesses whether the lessee is reasonably certain to exercise an option to extend the lease or to purchase the underlying asset, or not to exercise an option to terminate the lease. The entity considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise, or not to exercise, the option, including any expected changes in facts and circumstances from the commencement date until the exercise date of the option. Examples of factors to consider include, but are not limited to:
- (a) Contractual terms and conditions for the optional periods compared with market rates, such as:

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- (i) The amount of payments for the lease in any optional period;
 - (ii) The amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
 - (iii) The terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
 - (b) Significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
 - (c) Costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
 - (d) The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset, the location of the underlying asset and the availability of suitable alternatives; and
 - (e) Conditionality associated with exercising the option (i.e., when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.
- B38 An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph B42, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.
- B39 The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.
- B40 A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.

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- B41 Paragraph 20 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:
- (a) Significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
 - (b) A significant modification to, or customization of, the underlying asset that was not anticipated at the commencement date;
 - (c) The inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and
 - (d) A business decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of a business unit within which the right-of-use asset is employed).

Sale and leaseback transactions—Draft section of core Standard and Basis for Conclusions

Question

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

Detail

2. At the September 2016 meeting, the IPSASB directed staff to draft text to be included in the core Standard on guidance about sales that are in the context of a sale and leaseback transaction and a draft Basis for Conclusions on why the IPSASB took this decision.
3. [Appendix A](#) provides draft text, marked-up for changes from IFRS 16, *Leases*, to be included in the core text of the Exposure Draft on Leases and a draft Basis for Conclusions.

Decision required

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

Appendix A – Exposure Draft Section on Sale and Leaseback Transactions

EXPOSURE DRAFT XX, *LEASES*

Sale and leaseback transactions (marked-up¹⁵ from IFRS 16, *Leases*)

- 1¹⁶. If an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor, both the seller-lessee and the buyer-lessor shall account for the transfer contract and the lease applying paragraphs 2–6.

Assessing whether the transfer of the asset is a sale

2. An entity shall apply the requirements of IPSAS 9, *Revenue from Exchange Transactions*, to determine whether the transfer of an asset is accounted for as a sale of that asset.

Transfer of the asset is a sale

3. If the transfer of an asset by the seller-lessee satisfies the requirements of IPSAS 9 to be accounted for as a sale of the asset:
- (a) The seller-lessee shall measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognize only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.
 - (b) The buyer-lessor shall account for the purchase of the asset applying applicable Standards, and for the lease applying the lessor accounting requirements in this Standard.
4. If the fair value of the consideration for the sale of an asset does not equal the fair value of the asset, or if the payments for the lease are not at market rates, an entity shall make the following adjustments to measure the sale proceeds at fair value:
- (a) Any below-market terms shall be accounted for as a prepayment of lease payments; and
 - (b) Any above-market terms shall be accounted for as additional financing provided by the buyer-lessor to the seller-lessee.
5. The entity shall measure any potential adjustment required by paragraph 4 on the basis of the more readily determinable of:
- (a) The difference between the fair value of the consideration for the sale and the fair value of the asset; and
 - (b) The difference between the present value of the contractual payments for the lease and the present value of payments for the lease at market rates.

¹⁵ The text is not marked-up for amendments related to North American English or IPSASB's editorial style.

¹⁶ Paragraph numbering will be updated in full draft ED.

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Transfer of the asset is not a sale

6. If the transfer of an asset by the seller-lessee does not satisfy the requirements of IPSAS 9 to be accounted for as a sale of the asset:
 - (a) The seller-lessee shall continue to recognize the transferred asset and shall recognize a financial liability equal to the transfer proceeds. It shall account for the financial liability applying IPSAS 29, *Financial Instruments: Recognition and Measurement*¹⁷.
 - (b) The buyer-lessor shall not recognize the transferred asset and shall recognize a financial asset equal to the transfer proceeds. It shall account for the financial asset applying IPSAS 29.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS XX, Leases

Sale and leaseback transactions

1. The IPSASB considered the IFRS 16, *Leases* requirement to apply the requirements for determining when a performance obligation is satisfied in IFRS 15, *Revenue from Contracts with Customers*, to determine whether the transfer of an asset is accounted for as a sale of that asset.
2. The IPSASB is of the view that a sale entered into as part of a sale and leaseback transaction should be accounted in the same way as other sales of goods. However, currently the IPSASB does not have an IPSAS primarily drawn from IFRS 15. IPSAS 9, *Revenue from Exchange Transactions* follows a risks and rewards of ownership approach to the recognition of revenue from the sale of goods.
3. The IPSASB considers that the new IPSAS on Leases should have a similar requirement as in IFRS 16, adapted to reflect public sector issues. Therefore, the IPSASB decided that, until a new IPSAS on revenue is published, sales entered into as part of a sale and leaseback transaction should follow the requirements in IPSAS 9 for other sales of goods. The IPSASB has made public a preliminary view that an IPSAS, primarily drawn from IFRS 16 should replace IAS 9 and IAS 11, *Construction Contracts*.

¹⁷ The IPSASB has a project to replace the IPSASB's financial instruments Standards with a new financial instruments Standard based on IFRS 9, *Financial Instruments*.