

Agenda Item 7: Leases

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IPSASB Meeting

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Objective of Session & Material Presented

- Agenda Item 7.2.1—Lessor—Analysis of lessor accounting approaches to the right-of-use model
- Agenda Item 7.2.2—Leases for zero or nominal consideration
- Agenda Item 7.2.3—Lessee—Reassessment of the lease liability and lease modifications
- Agenda Item 7.2.4—Sale and leaseback transactions

Lessee—Reassessment of the lease liability (...) (Agenda Item 7.2.3)

- **Staff did not identify** a public sector specific reason not to apply the IFRS 16 requirements on:
 - Reassessment of the lease liability;
 - Lease modifications;
 - Separating components of a contract (from the lessee side); and
 - Lease term.

Lessee—Reassessment of the lease liability (...) (Agenda Item 7.2.3)

- **Matter for consideration**

Does the IPSASB support the adoption of IFRS 16 requirements on:

- (a) Reassessment of the lease liability;
- (b) Lease modifications;
- (c) Separating components of a contract (lessee side); and
- (d) Lease term?

(see Appendix A of Agenda Item 7.2.3 for details)

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Two issues:**
 - Draft text to be included in the core Standard and in the Basis for Conclusions
 - IFRS 16 consequential amendments to IFRS 15, *Revenue from Contracts with Customers*

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Draft text to be included in the core Standard and in the Basis for Conclusions:**
 - Replace the reference IFRS 15 with IPSAS 9; and
 - Include an explanation in the Basis for Conclusions.

(see Appendix A of Agenda Item 7.2.4 for details)

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Matter for consideration**

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

Sale and leaseback transactions (Agenda Item 7.2.4)

- **IFRS 16 consequential amendments to IFRS 15, *Revenue from Contracts with Customers*:**
 - IFRS 16 includes several consequential amendments to the Application Guidance of IFRS 15 in the repurchase agreements section (IFRS 15.B64-B76);
 - The IPSASB does not have an equivalent to IFRS 15;
 - Two options to deal with the consequential amendments to IFRS 15 in IFRS 16

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Two options to deal with the consequential amendments to IFRS 15 in IFRS 16**
 - **Option 1**—Do not include the IFRS 15 guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9, and include the guidance later in the new or revised IPSAS on Revenue; and
 - **Options 2**—Include the IFRS 15 guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9.

Sale and leaseback transactions (Agenda Item 7.2.4)

- Two options to deal with the consequential amendments to IFRS 15 in IFRS 16

Criteria	Option 1	Option 2
Advantages	<ul style="list-style-type: none">• Maintains the current situation in IPSAS 9 based on risks and rewards.	<ul style="list-style-type: none">• Ensures a consistent treatment of sale and leaseback in the context of repurchase agreements.
Disadvantages	<ul style="list-style-type: none">• No consistency with IFRS 15 and IFRS 16.	<ul style="list-style-type: none">• Creates an internal conceptual inconsistency in IPSAS 9 (control versus risks and rewards).

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Two options to deal with the consequential amendments to IFRS 15 in IFRS 16**

Staff's recommendation

- **Option 1** because the internal conceptual inconsistency that Option 2 implies can have unpredictable harmful consequences in the applicability of IPSAS 9.

Sale and leaseback transactions (Agenda Item 7.2.4)

- **Two options to deal with the consequential amendments to IFRS 15 in IFRS 16**

Matter for consideration

- Does the IPSASB support:
 - Option 1 (do not include the repurchase agreements section in IFRS 15, which includes the sale and leaseback guidance) in IPSAS 9; or
 - Option 2 (include the IFRS 15 guidance on repurchase agreements, which includes the guidance on sale and leaseback) in IPSAS 9?



Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Decisions** from IPSASB December 2016 meeting
 - Additional consistency analysis of the two approaches to the right-of-use model for lessor accounting with:
 - Sale and leaseback transaction
 - IPSAS 16, *Investment Property*
 - Exploring when on a sliding scale (or spectrum) of transactions does the transfer of the control of assets occur

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

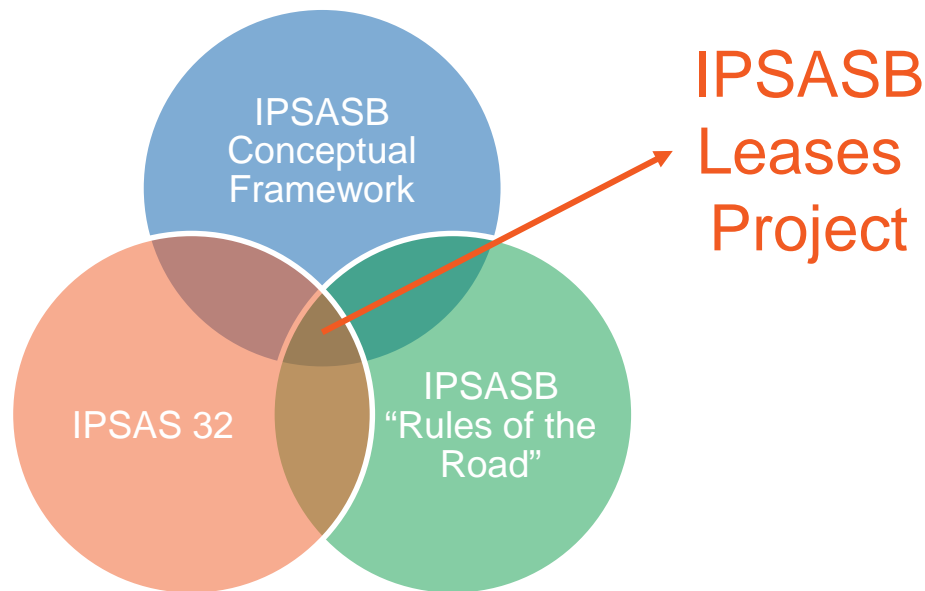
• Background

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

	Approach 1	Approach 2
Underlying asset	Continues to recognize the underlying asset <u>in its entirety</u>	Derecognizes portions <u>of rights</u> of the underlying asset transferred to the lessee
Credit entry	Recognized in the statement of financial position and reduced subsequently over the lease term as revenue is recognized in the statement of financial performance	Recognized immediately in the statement of financial performance
	 Not a sale of assets	 Sale of assets

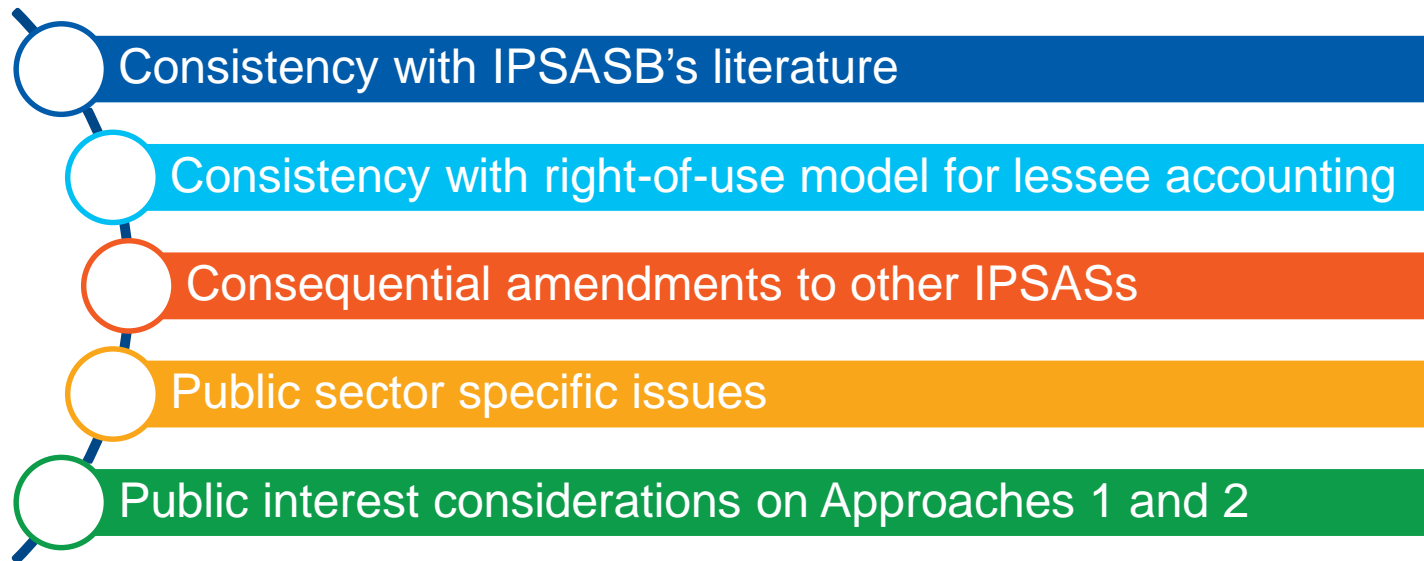
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- Methodology – Boundaries



Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis for Lessor Accounting



Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

• **Methodology** – Criteria of Analysis – Main Conclusions

Recognition and derecognition of the underlying asset - entirety versus portions

Criteria	Approach 1	Approach 2
I – Consistency with IPSASB's existing literature		
IPSAS 16 and IPSAS 17	Consistent	Not consistent
Sale and leaseback	Consistent	Not consistent
IPSAS 32	Consistent	Not consistent
Conceptual Framework	Consistent	Not consistent
Joint Control (IPSAS 37)	Not applicable to leases	

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

• Methodology – Criteria of Analysis – Main Conclusions

Recognition and derecognition of the underlying asset - entirety versus portions

Criteria	Approach 1	Approach 2
II – Consistency with right-of-use model for lessee accounting		
Underlying asset	Consistent at type of asset level (the lessee controls the intangible right-of-use asset, and the lessor controls the physical asset)	<ul style="list-style-type: none"> Inconsistent at type of asset level (the lessee controls the intangible right-of-use asset, and the lessor controls the intangible right to receive back the underlying asset). Neither the lessee nor the lessor recognize the physical asset.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

• **Methodology** – Criteria of Analysis – Main Conclusions

Recognition and derecognition of the underlying asset - entirety versus portions

Criteria	Approach 1	Approach 2
III – Consequential amendments to other IPSASs		
	<ul style="list-style-type: none"> • IPSAS 16 – Exclude the lease receivable in subsequent measurement • IPSAS 32 – Term “liability” needs to be amended 	<ul style="list-style-type: none"> • Amend the principles in IPSAS 16, IPSAS 17, and IPSAS 32; or • New IPSAS with different guidance from IPSAS 16, IPSAS 17 and IPSAS 32

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- Methodology – Criteria of Analysis – Main Conclusions**

Recognition and derecognition of the underlying asset - entirety versus portions

Criteria	Approach 1	Approach 2
IV – Public sector specific issues		
Accountability	Focus on physical asset in its entirety	Focus on individual rights (bundle of rights) over physical assets
Decision-making		
V – Public Interest Considerations		
	Physical asset is always recognized in the financial statements of lessor.	Physical asset is not recognized in the financial statements of lessee and lessor.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology – Criteria of Analysis – Main Conclusions**

Recognition and derecognition of the underlying asset - entirety versus portions

- **Approach 1:**

- Does not break the principles in IPSAS 16, IPSAS 17 and IPSAS 32
- Is consistent with a control-based approach to recognize assets

- **Approach 2:**

- Conflicts with the principles in IPSAS 16, IPSAS 17 and IPSAS 32
- Is inconsistent with a control-based approach to recognize assets

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Matter for consideration**

Does the IPSASB support to include in the Exposure Draft on Leases:

- (a) Approach 1 to lessor accounting (continuing to recognize the underlying asset in its entirety)?
- (b) Approach 2 to lessor accounting (derecognizing portions (“slices”) of the underlying asset transferred to the lessee)?
- (c) Inclusion of an Alternative View supporting the approach that is not proposed in the Exposure Draft?

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology – Criteria of Analysis**

Recognition of credit entry – Conceptual Framework

Approach 1 – In the statement of financial position and subsequently over the lease term as revenue is recognized in the statement of financial performance

Approach 2 – In the statement of financial performance

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- Methodology – Criteria of Analysis – Main Conclusions**

Recognition of credit entry

Criteria	Approach 1	Approach 2
I – Consistency with IPSASB's existing literature		
IPSAS 32	Consistent	Not consistent
Conceptual Framework	Not conclusive	

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions
Recognition of credit entry – Conceptual Framework

Three possible ways:

- a) Liability;
- b) Revenue; and
- c) Other obligation.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions
Recognition of credit entry – Conceptual Framework

Liability:

“A present obligation of the entity for an outflow of resources that results from a past event.”

Revenue:

“Increases in the net financial position of the entity, other than arising from ownership contributions”.

Other obligation:

“Obligation that does not satisfy the definition of an element defined in the Conceptual Framework.”

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Net financial position:

“Difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.”

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Liability?

The TBG and staff are of the view that the credit entry **does not meet the definition of a liability** because there is no present obligation of the entity for an outflow of resources.



The credit entry (unearned revenue) cannot be presented as a liability in the statement of financial position.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Revenue?

Staff has concluded that the economics of a lease is not that of a sale of separately recognized asset.



Revenue should not be recognized immediately in the statement of financial performance.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Revenue?

Task
Based
Group
views:

Some support for initial recognition of the entire amount at inception of the lease in the statement of financial performance.

Some support for recognition over the lease term in the statement of financial performance.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions
Recognition of credit entry – Conceptual Framework

Revenue?

The Conceptual Framework does not link elements to a particular financial statement.



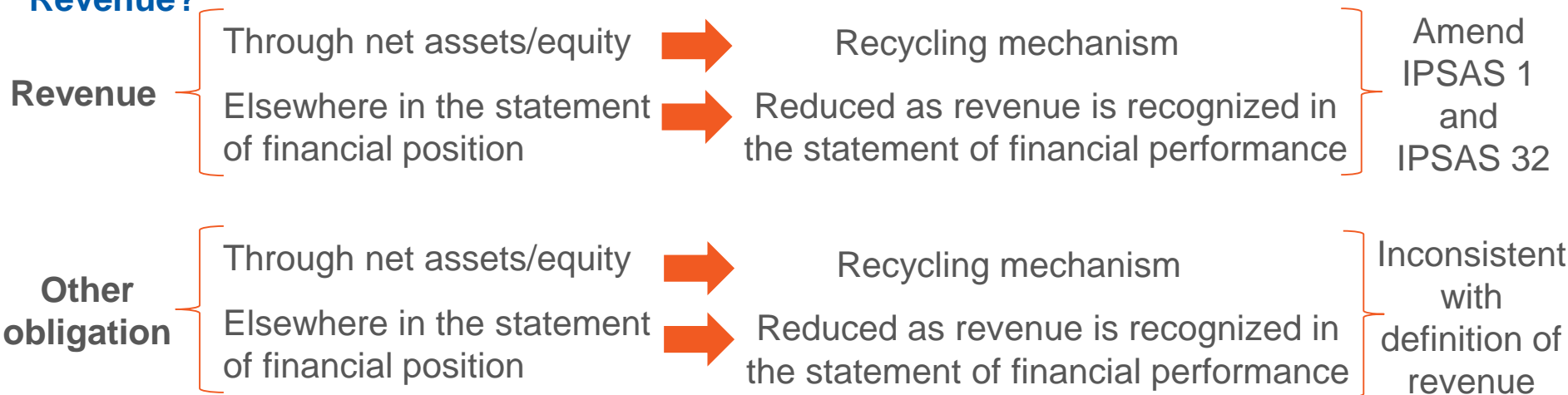
Revenue may be initially recognized
in any financial statement.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- Methodology – Criteria of Analysis – Main Conclusions**

Recognition of credit entry – Conceptual Framework

Revenue?



Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Revenue?

Revenue in the statement of financial position



Inconsistent with
IPSASB's decision not to
include deferred inflows
and deferred outflows as
elements in the
Conceptual Framework



The IPSASB included
other obligations and other
resources as possible
approaches to addressing
deferrals in the
Conceptual Framework

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Methodology** – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

Revenue?

Other obligation in the statement of financial position



Inconsistent with definition of revenue



The IPSASB may conclude that, where there is no matching liability, revenue should be recognized in the statement of financial performance. This could justify the treatment of the credit as an other obligation.

Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

- **Matter for consideration**

Does the IPSASB support to include in the Exposure Draft on Leases:

- (a) Approach 1 to lessor accounting (recognize revenue over the lease term in the statement of financial performance)?
- (b) Approach 2 to lessor accounting (recognize revenue immediately in the statement of financial performance)?
- (c) Inclusion of an Alternative View supporting the approach that is not proposed in the Exposure Draft?

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- **Background**

- The IPSASB still has not decided on where and how to provide requirements and guidance for concessionary leases in the Leases project.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- **Background**

- At the December 2016 meeting, the IPSASB decided to:
 - Measure leases that are exchange transactions at cost and measure concessionary leases at fair value; and
 - Account for the subsidized component of concessionary leases in the same way as for concessionary loans.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- **Two types of concessionary leases**
 - Leases for zero or nominal consideration; and
 - Leases above zero or nominal consideration, but below fair value.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- **Leases for zero or nominal consideration**
 - In substance a grant or a donation in kind;
 - Inconsistent with the economic rationale of right-of-use model
 - Leases are financings of the right to use an underlying asset
 - Inconsistent with the IFRS 16 definition of a lease
 - “in exchange for consideration”
 - Inconsistent with concessionary loans
 - All loans have a repayment obligation, even if the principal and interest rate have a concessionary nature.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- Options for guidance on leases for zero or nominal consideration

Criteria	Option 1	Option 2
Donation in kind vs financing transaction	In the Non-Exchange Expense project and IPSAS 23	In the Leases project
IFRS 16 definition of a lease	Retained	Remove the wording “in exchange for consideration”
Concentration vs dispersion of subject in IPSASs	<ul style="list-style-type: none"> Include guidance on concessionary leases that are similar to concessionary loans. Amend IPSAS 23 in the same way as for concessionary loans. 	<ul style="list-style-type: none"> Include guidance on both types of concessionary leases. Amend IPSAS 23 in the same way as for concessionary loans.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- Options for guidance on leases for zero or nominal consideration

Criteria	Option 1	Option 2
Advantages	<ul style="list-style-type: none">Maintains consistency with the IFRS 16 definition of a lease.Increases internal consistency of IPSAS on Leases because includes only transactions that have the same economic nature.Increases consistency with IPSAS 29.	<ul style="list-style-type: none">Preparers will find guidance on all types of “leases” or arrangements with some of the characteristics of a lease as currently defined in a single Standard.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- Options for guidance on leases for zero or nominal consideration

Criteria	Option 1	Option 2
Disadvantages	<ul style="list-style-type: none">Preparers need to find guidance on leases in different Standards depending on whether there is or not consideration.There will be no guidance on how to account for the subsidized component from the lessor side until the new Standard on Non-Exchange Expense is approved.	<ul style="list-style-type: none">Does not maintain consistency with the IFRS 16 definition of a lease.Lack of consistency in the IPSAS on Leases because includes transactions with different economic natures.Lack of consistency with IPSAS 29.

Leases for zero or nominal consideration (Agenda Item 7.2.2)

- **Matter for consideration**

Does the IPSASB support:

- (a) Including guidance on leases for zero or nominal consideration in a future IPSAS on Non-Exchange Expenses (Option 1)?; or
- (b) Including guidance on leases for zero or nominal consideration in the Exposure Draft on Leases (Option 2)?

(see Appendix A of Agenda Item 7.2.2 for details on the options)



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