

**Meeting:** International Public Sector Accounting Standards Board

**Meeting Location:** Luxembourg, Luxembourg

**Meeting Date:** June 27–30, 2017

**From:** João Fonseca

## Agenda Item 10

For:

☐ Approval

☒ Discussion

☒ Information

### LEASES

<b>Project summary</b>	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> .	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Project management</b>	Instructions up to December 2016 meeting	<a href="#">10.1.1</a>
	Decisions up to December 2016 meeting	<a href="#">10.1.2</a>
	Project roadmap	<a href="#">10.1.3</a>
<b>Decisions required at this meeting</b>	Terminology: Conceptual Framework and IPSASs	<a href="#">10.2.1</a>
	Objective, Scope and Definitions	<a href="#">10.2.2</a>
	Lessor: Recognition exemptions	<a href="#">10.2.3</a>
	Identifying a lease, in-substance fixed lease payments, and lessee involvement with the underlying asset before the commencement date	<a href="#">10.2.4</a>
	Manufacturer or dealer lessors	<a href="#">10.2.5</a>
	Lessor–Separating components of a contract	<a href="#">10.2.6</a>
	Lessor–Lease modifications	<a href="#">10.2.7</a>
	Sale and leaseback transactions at below market terms	<a href="#">10.2.8</a>
	Lessor–Credit entry	<a href="#">10.2.9</a>
	Lessor–Measurement	<a href="#">10.2.10</a>
<b>Other supporting items</b>	Exposure Draft Development–Process	<a href="#">10.3</a>
	Draft Exposure Draft, <i>Leases</i> (marked-up from IFRS 16, <i>Leases</i> )	<a href="#">10.4</a>

### INSTRUCTIONS UP TO MARCH 2017 MEETING

Meeting	Instruction	Actioned
June 2016	<p>The IPSASB <b>directed</b> staff to bring the following issues and items to future meetings:</p> <ul style="list-style-type: none"> <li>• Recognition exemptions and threshold of leases of low-value assets;</li> <li>• Presenting some fact patterns based on several types of “peppercorn leases”;</li> <li>• Explaining in more detail the IFRS 16 lessor accounting model;</li> <li>• Analysing 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;</li> <li>• Present a high level history of the IASB’s project to explore why and when IASB modified their proposals for lessor accounting;</li> <li>• Explain how property and vehicle leases are accounted for in existing guidance in IPSAS 13 and in IFRS 16.</li> </ul>	
September 2016	<p>The IPSASB <b>directed</b> staff to:</p> <ul style="list-style-type: none"> <li>• 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;</li> <li>• Analyse 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.</li> </ul>	
December 2016	<p>The IPSASB <b>directed</b> staff to do additional consistency analysis of Approaches 1 (continuing to recognize the underlying asset in its entirety) and 2 (derecognition of portion of the underlying asset) for lessor accounting with sale and leaseback, explore when on a sliding scale (or spectrum) of transactions does the transfer of the control of assets occur, and IPSAS 16, <i>Investment Property</i>.</p>	

Meeting	Instruction	Actioned
March 2017	<p>The IPSASB <b>directed</b> staff to include additional guidance in the Application Guidance section of the Exposure Draft on leases that are renewed on annual basis for budgetary reasons and to do additional analysis of the relationship between:</p> <ul style="list-style-type: none"><li>• The Leases project and the Revenue and Non-Exchange Expense project on the economic nature of the credit entry in lessor accounting; and</li><li>• IFRS 16 accounting requirements of a sale and leaseback transaction below market terms and concessionary leases.</li></ul>	

### DECISIONS UP TO MARCH 2017 MEETING

Date of Decision	Decision
June 2016	<ul style="list-style-type: none"> <li>To apply the right-of-use model to lessee accounting in the Exposure Draft on Leases;</li> <li>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;</li> <li>To adopt the IFRS 16 recognition exemptions in the Exposure Draft on Leases;</li> <li>Recognition exemptions should be an option, rather than a requirement, in the Exposure Draft on Leases;</li> </ul>
September 2016	<ul style="list-style-type: none"> <li>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>;</li> <li>The IPSASB decided not to adopt the lessor accounting requirements in IFRS 16, <i>Leases</i>;</li> </ul>
December 2016	<ul style="list-style-type: none"> <li>Replace the term "peppercorn leases" with the term "concessionary leases";</li> <li>Measure leases that are exchange transactions at cost and measure concessionary leases at fair value;</li> <li>Account for the subsidized component in a concessionary lease in the same way as in a concessionary loan;</li> </ul>
March 2017	<ul style="list-style-type: none"> <li>To adopt a control-based approach to lessor accounting for the underlying asset in a lease and rejected the approach to derecognize portions of rights of the underlying asset transferred to the lessee;</li> <li>To treat leases for zero or nominal consideration in the Non-Exchange Expense project (transferor side) and IPSAS 23, <i>Revenue from Non-Exchange Transactions</i> (recipient side) like any other donation in kind;</li> <li>Agreed with the draft sections on: (i) lessee–reassessment of the lease liability, lease modifications, and separating components of a contract, and (ii) Lease term without any amendments;</li> <li>Agreed with the draft sections on Sale and Leaseback Transactions, including the Basis for Conclusions, without amendments;</li> <li>Not to include the IFRS 15, <i>Revenue from Contracts with Customers</i> guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9, <i>Revenue from Exchange Transactions</i>, and include the guidance later in the new or revised IPSAS on Revenue;</li> </ul>

### LEASES PROJECT ROADMAP

Meeting		Objective: IPSASB to consider:
2016	March	<ol style="list-style-type: none"> <li>1. Education Session on IFRS 16</li> <li>2. First draft of Project Brief, <i>Leases</i></li> </ol>
	June	<ol style="list-style-type: none"> <li>1. Approval of Project Brief, <i>Leases</i></li> <li>2. Lessee—Applicability of IFRS 16 recognition and measurement requirements to public sector financial reporting</li> <li>3. Lessee—"Peppercorn" leases (no decision taken)</li> <li>4. Lessor—Applicability of IFRS 16 recognition requirements to public sector financial reporting</li> </ol>
	September	<ol style="list-style-type: none"> <li>1. Lessor—Applicability of grant of a right to the operator model in IPSAS 32 to lessor accounting (right-of-use model)</li> <li>2. Sale and leaseback transactions</li> <li>3. Lessee—Recognition Exemptions—Threshold of leases for which the underlying asset is of low value</li> </ol>
	December	<ol style="list-style-type: none"> <li>1. Lessor—Analysis of lessor accounting approaches to the right-of-use model</li> <li>2. Lease—Measurement (including concessionary leases)</li> </ol>
2017	March	<ol style="list-style-type: none"> <li>1. Lessor—Analysis of lessor accounting approaches for the right-of-use model</li> <li>2. Leases for zero or nominal consideration</li> <li>3. Lessee—Reassessment of the lease liability and lease modifications; lease term</li> <li>4. Sale and leaseback transactions—Draft section of Core Standard and Basis for Conclusions</li> </ol>
	June	<ol style="list-style-type: none"> <li>1. Terminology: Conceptual Framework and IPSASs</li> <li>2. Objective, Scope and Definitions</li> <li>3. Lessor: Recognition Exemptions</li> <li>4. Identifying a lease, in-substance fixed lease payments, and lessee involvement with the underlying asset before the commencement date</li> <li>5. Manufacturer or dealer lessor</li> <li>6. Lessor: Separating components of a contract</li> <li>7. Lessor: Lease modifications</li> <li>8. Sale and leaseback transactions below market terms</li> <li>9. Lessor-Credit entry</li> <li>10. Lessor-Measurement</li> <li>11. Review of first draft ED</li> </ol>

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Meeting		Objective: IPSASB to consider:
	September	<ol style="list-style-type: none"> <li>1. Presentation: lessee and lessor</li> <li>2. Disclosures: lessee and lessor (including concessionary leases)</li> <li>3. Effective date and transition</li> <li>4. Amendments to other IPSASs</li> <li>5. Illustrative examples (including concessionary leases)</li> <li>6. Review of draft ED</li> <li>7. Approval of ED</li> </ol>
	December	Exposure period
2018	March	
2018	June	<ol style="list-style-type: none"> <li>1. Review of Responses: Objective, Scope and Exemptions</li> <li>2. Review of Responses: Identifying a lease</li> <li>3. Review of Responses: Recognition and measurement—Lessee and lessor</li> </ol>
	September	<ol style="list-style-type: none"> <li>1. Review of Responses: Presentation—Lessee and lessor (including "peppercorn leases")</li> <li>2. Review of Responses: Disclosures—Lessee and Lessor (including "peppercorn leases")</li> <li>3. Review of Responses: Sale and Leaseback Transactions</li> <li>4. Review of Responses: Terminology—Conceptual Framework</li> </ol>
	December	<ol style="list-style-type: none"> <li>1. Review of draft IPSAS</li> <li>2. Approval of new IPSAS</li> </ol>

### Terminology–Conceptual Framework and IPSASs

#### Question

- Whether the IPSASB agrees with the staff's proposed terminology changes to IFRS 16 in the draft Exposure Draft on Leases?

#### Detail

- Staff notes that “fair value” is used in IFRS 16, *Leases*, where the Conceptual Framework uses the term “market value”.
- Staff recommends that the Exposure Draft retains “fair value” because:
  - The IPSASB has agreed to continue the use of “fair value” in recent IPSASs and ongoing projects<sup>1</sup>; and
  - There is an on-going project on Measurement that will deal with the measurement bases across all Standards.
- Staff also proposes the following terminology changes for consistency with IPSASs literature:

IFRS 16	IPSAS Exposure Draft
Income	Revenue
Profit	Surplus
Loss	Deficit
Business unit	Operation
Business segment	Segment

#### Decisions required

- Does the IPSASB agree with the proposed terminology changes included in the draft Exposure Draft on Leases?

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<sup>1</sup> Since the Conceptual Framework was issued, the IPSASB has agreed to use the term “fair value” in IPSAS 33, *First-Time Adoption of Accrual Basis IPSASs*, IPSAS 34-38, *Interests in Other Entities*, IPSAS 39, *Employee Benefits* and IPSAS 40, *Public Sector Combinations*.

**Objective, Scope and Definitions****Question**

1. Whether the IPSASB agree with staff's analysis on objective, scope and definitions in the draft Exposure Draft on Leases?

**Detail***Objective*

2. Staff notes that changes in mark-up in the objective paragraph reflect that the IPSASB has proposed public sector specific lessor accounting requirements in the Exposure Draft. See [Appendix A](#) to this issues paper for further explanation.

*Scope*

3. Paragraphs 3 and 4 of the draft Exposure Draft on Leases provide the scope of the new Standard on Leases based on IFRS 16, *Leases* (see Agenda Item 10.4), but adapted to IPSASB's literature. Staff did not identify a public sector specific reason that warrant a different scope, except for the scope exclusion of leases for zero or nominal consideration (see paragraph 3(f) of the draft Exposure Draft).
4. The objective of the additional scope exclusion is to implement the IPSASB's decision to exclude from the draft Exposure Draft for zero or nominal consideration as agreed at its March 2017 meeting.
5. Staff notes that the Scope section of the draft Exposure Draft is marked-up from IFRS 16.

*Definitions*

## Definition of a contract

6. The Exposure Draft proposes to define the term "contract" and adopt it in the definition of a lease. The term "contract" is not currently a defined term in IPSASs. The term "contract" is defined in IFRS 15, *Revenue from Contracts with Customers*.
7. Staff notes that in the public sector there are other forms of arrangements that do not take the form of a documented contract. For example, an arrangement between two government departments that do not take the form of a contract because they do not have the power to do so.
8. As some might argue that this could be an argument to amend the definition of a lease, staff has identified two options to deal with this issue:
  - (a) Option 1—Retain the IFRS 16 term "contract" in the definition of a lease, add the definition to the IPSASB's glossary of defined terms, and provide additional guidance in the Application Guidance section to explain that an entity should consider the substance rather than the legal form of an arrangement in determining whether it is a "contract" for the purposes of the Standard on Leases; and



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- (b) Option 2—Replace the IFRS 16 term “contract” in the definition of a lease with a definition of “binding arrangement” to be used only for the purpose of the leasing standard and explain the rationale in the Basis for Conclusions.

9. Staff has identified the following advantages and disadvantages for each option:

	Option 1	Option 2
Advantages	<ul style="list-style-type: none"> <li>Consistency with IFRS 16, IPSAS 28<sup>2</sup>, and the IPSAS's project to update IPSAS 28-30</li> </ul>	<ul style="list-style-type: none"> <li>Consistency with IPSAS 32<sup>3</sup></li> </ul>
Disadvantages	<ul style="list-style-type: none"> <li>Inconsistency with IPSAS 32</li> </ul>	<ul style="list-style-type: none"> <li>Consistency with IFRS 16, IPSAS 28, and the IPSAS project to update IPSAS 28-30</li> </ul>

10. Staff supports Option 1 because:
- (a) Both proposed draft Application Guidance and Basis for Conclusions will inform preparers that the term “contract” would require that a lease be legally enforceable; and
- (b) Keeps convergence with IFRS 16, consistency with IPSAS 28, and the IPSAS's project to update IPSAS 28-30.
11. The IPSASB will need to decide whether it wants to keep the term “contract” or replace it with the term “binding arrangement”.
12. Staff notes that the term “contract” is not defined in IPSASB's literature. Staff is also proposing to use the IFRS definition of a contract without amendments because staff did not identify a public sector specific reason that warrant a different definition.
13. [Appendix B](#) below provides the draft of the Application Guidance and Basis for Conclusions for both options. The draft Exposure Draft on Leases (Agenda Item 10.4) includes Option 1.

### Other definitions

14. [Appendix A](#) below provides a table that summarizes staff's approach to IFRS 16 definitions in the Exposure Draft on Leases.
15. The changes to IFRS 16 definitions are the following:
- (a) Second column of the table in [Appendix A](#)—Amendments to the definitions “initial direct costs” and “interest rate implicit in the lease” to remove the reference to IFRS 16 lessor accounting requirements, as follows:

Initial direct costs are incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, ~~except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.~~

<sup>2</sup> See IPSAS 28.AG20 and IPSAS 28.BC15-16

<sup>3</sup> See IPSAS 32.BC10

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The interest rate implicit in the lease is the rate of interest that causes the present value of ~~(a) the lease payments and (b) the unguaranteed residual value~~ to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.

- (b) Third column of the table in [Appendix A](#)—Exclusion from the draft Exposure Draft of the following definitions:
- (i) Fair value—This definition is included in IPSAS 9, *Revenue from Exchange Transactions*;
  - (ii) Unguaranteed residual value—The definition is directly related with manufacturer or dealer lessor, and, in [Agenda Item 10.2.5](#), staff is proposing not to include the IFRS 16 guidance on manufacturer or dealer lessor in the context of finance leases; and
  - (iii) Useful life—This definition is included in IPSAS 17, *Property, Plant and Equipment*
  - (iv) The remaining terms are related to IFRS 16 lessor accounting that the IPSASB decided<sup>4</sup> not to apply in the Exposure Draft.

16. Staff notes that the Definitions section of the draft Exposure Draft is a clean version from IFRS 16 with staff's proposals.

### Decisions required

17. Does the IPSASB agree:
- (a) With staff's approach to the Objective and Scope of the Exposure Draft?
  - (b) To retain the term "contract" or replace it with the term "binding arrangement" in the Exposure Draft?
  - (c) With the amendments to the definitions "initial direct costs" and "interest rate implicit in the lease" in the draft Exposure Draft?
  - (d) With the exclusion of definitions identified in paragraph 15(b ) from the Exposure Draft?

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<sup>4</sup> IPSASB's decision at the September 2016 meeting.

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## 10.2.2

### Appendix A – Amendments to IFRS 16 Objective and Definitions in the draft Exposure Draft on Leases

#### Objective

1. Paragraphs 1 and 2 of the Exposure Draft on Leases (see Agenda Item 10.4) provide the objective of the new Standard on Leases in the exact same way as in IFRS 16, *Leases*, except for the addition of the objectives of public sector financial reporting of accountability and decision-making shown in mark-up at the end of paragraph 1. Staff proposes this amendments to IFRS 16 objective because:
  - (a) The IPSASB decided to deviate from IFRS 16 requirements on lessor; and
  - (b) Providing the exact same IFRS 16 objective in an IPSAS on Leases that is specifically designed for the public sector with a different lessor accounting model might be misleading for users that use both IFRSs and IPSASs.

#### Definitions

2. The table below summarizes staff's approach to IFRS 16 definitions in the Exposure Draft on Leases.

<b>(a) Include in the Exposure Draft without amendments</b>	<b>(b) Include in the Exposure Draft with amendments</b>	<b>(c) Not include in the Exposure Draft</b>
commencement date of the lease (commencement date)	initial direct costs	fair value
contract	interest rate implicit in the lease	finance lease
economic life		gross investment in the lease
effective date of the modification		net investment in the lease
fixed payments		operating lease
inception date of the lease (inception date)		unearned finance income
lease		unguaranteed residual value
lease incentives		useful life
lease modification		
lease payments		
lease term		
lessee		
lessee's incremental borrowing rate		
lessor		
optional lease payments		
period of use		
residual value guarantee		
right-of-use asset		
short-term lease		
sublease		
underlying asset		
variable lease payments		

### APPENDIX B – Draft text for Exposure Draft on Leases based on Option 1 and Option 2

#### Option 1 – Retain the word “contract” in the definition of a lease

##### Definitions

A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

##### Application Guidance

##### *Definitions*

##### Contractual Arrangements

AG1. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a “contract” for purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- (a) Contracts involve willing parties entering into an arrangement;
- (b) The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and
- (c) The remedy for non-performance is enforceable by law.

##### Basis for Conclusions

##### *Definitions*

##### Contractual Arrangements

- BC.1 The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a “government order.” To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.
- BC2. Consideration was given as to whether the term “binding arrangement” should be used to describe the arrangements highlighted in paragraph BC1. The term “binding arrangement” is defined as contracts and other arrangements that confer similar rights and obligations on the

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parties to it as if they were in the form of a contract. For example, an arrangement between two government departments that do not have the power to contract. The IPSASB concluded that the term “binding arrangements,” as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph BC1 and therefore concluded that it should not be used in this [draft] IPSAS.

### **Option 2 – Replace the word “contract” in the definition of a lease with binding arrangement**

#### **Definitions**

**A lease is a binding arrangement, or part of a binding arrangement, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.**

#### **Basis for Conclusions**

##### *Definitions*

##### Contractual Arrangements

- BC.1 The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a “government order.”
- BC2. Consideration was given as to whether the IPSAS defined term “binding arrangement” should be used to describe the arrangements highlighted in paragraph BC1. The term “binding arrangement” is defined as contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. For example, an arrangement between two government departments that do not have the power to contract. The IPSASB concluded that the term “binding arrangements” should be used in this Standard to ensure a consistent application of IPSASs’ definitions with other IPSASs that deal with transfer of some rights over assets.

**Lessor–Recognition exemptions****Question**

1. Whether the IPSASB agrees with staff's analysis on optional recognition exemptions for lessor accounting?

**Detail**

2. At the June 2016 meeting, the IPSASB agreed to adopt the IFRS 16 recognition exemptions for lessee accounting (short-term leases and leases for which the underlying asset is of low value) in the Exposure Draft on Leases.
3. The IPSASB also agreed that the recognition exemptions should be optional and not a requirement.
4. Staff is of the view that the reasons that led the IASB and IPSASB to adopt recognition exemptions for lessee accounting are also applicable to lessor accounting. Therefore, staff recommends the IPSASB that the same optional recognition exemptions for lessee accounting should be adopted for lessor accounting.
5. IFRS 16.B5 (corresponding paragraph AG6 of the draft Exposure Draft) provides additional criteria for lessees to classify leases for which the underlying asset is of low value. Staff did not identify additional criteria for lessors to classify leases for which the underlying asset is of low value.
6. The draft Exposure Draft includes the staff's recommendation in mark-up to IFRS 16, *Leases* (see paragraphs 6–9 and AG4–AG9 of the draft Exposure Draft).

**Decisions required**

7. Does the IPSASB agree with the staff's recommendation to:
  - (a) Adopt the optional recognition exemptions for lessor accounting on short-term leases and leases for which the underlying asset is of low value?
  - (b) Not include additional criteria for lessors to classify leases for which the underlying asset is of low value?

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## 10.2.4

### Identifying a lease, in-substance fixed lease payments, and lessee involvement with the underlying asset before the commencement date

#### Question

1. Whether the Board agrees with staff's recommendations on:
  - (a) How to identify a lease;
  - (b) In-substance fixed lease payments; and
  - (c) Lessee involvement with the underlying asset before the commencement date?

#### Detail

2. The draft Exposure Draft on Leases includes the following guidance from IFRS 16 without amendments:

(a) Identifying a lease		(b) In-substance fixed lease payments		(c) Lessee involvement with the underlying asset before the commencement date	
IFRS 16	ED	IFRS 16	ED	IFRS 16	ED
9–11, B9-B31	10–12, AG10–AG32	B42	AG48	B43–B44	AG49–AG53

3. Staff did not identify a public sector specific reason that warrant a different guidance in the Exposure Draft on Leases.
4. Therefore, staff recommends to include the IFRS 16 guidance on in the Exposure Draft on Leases.

#### Decisions required

5. Does the IPSASB agree with staff's recommendation to include in the Exposure Draft the IFRS 16 guidance on:
  - (a) How to identify a lease?
  - (b) In-substance fixed lease payments?
  - (c) Lessee involvement with the underlying asset before the commencement date?

**Manufacturer or dealer lessor****Question**

1. Whether the IPSASB agrees with staff's recommendation to exclude guidance on manufacturer or dealer lessor in the Exposure Draft on Leases?

**Detail**

2. IFRS 16, *Leases* includes guidance on manufacturer or dealer accounting requirements for lessors, which includes an assessment of the risks and rewards incidental to ownership for the lessor accounting model (see paragraphs IFRS 16.71-74 and strikethrough paragraphs 55-58 of the Exposure Draft on Leases).
3. Staff recommends the IPSASB that the manufacturer or dealer lessor guidance in IFRS 16 should be excluded from the Exposure Draft for the following reasons:
  - (a) The lessor model proposed for the Exposure Draft is not based on risks and rewards;
  - (b) Manufacturer or dealer lessor is expected to be very rare in the public sector (commonly found in the private sector in the auto industry); and
  - (c) Developing new manufacturer or dealer lessor accounting guidance in the context of the right-of-use model would require additional time to complete the project, while providing limited benefits given its application would be very rare in the public sector.
4. Paragraphs 71-77 and AG.53 (partial) related to manufacturer or dealer lessor accounting have been removed amended to reflect the staff's recommendation.

**Decisions required**

5. Does the IPSASB agree with staff's recommendation to exclude guidance on manufacturer or dealer lessor in the Exposure Draft on Leases?



### Lessor–Separating components of a contract

#### Question

1. Whether the IPSASB agrees with staff's recommendation on separating components in a lease contract in lessor accounting?

#### Detail

2. IFRS 16, *Leases* includes a cross-reference to paragraphs 73-90 of IFRS 15, *Revenue from Contracts with Customers* on how to allocate the consideration in a lease contract that contains a lease component and one or more additional lease or non-lease components (see IFRS 16.17 and paragraph 18 of the Exposure Draft). The objective of the guidance in IFRS 15 is to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.
3. IPSASB's literature does not have equivalent guidance at this time, however, does have an active project considering approaches to adapt IFRS 15 for the public sector.
4. The most applicable guidance in IPSASs at this time is included in paragraph 18 of IPSAS 9, *Revenue from Exchange Transactions*.

"The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the price of a product includes an identifiable amount for subsequent servicing, that amount is deferred, and recognized as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together."

5. Staff identifies two options to deal with this issue:
  - (a) Option 1—Replace the cross-reference to IFRS 15 with IPSAS 9; or
  - (b) Option 2—Remove paragraph 18 of the draft Exposure Draft on Leases.
6. Option 1 has the advantage of providing new guidance that did not exist in IPSAS 13, *Leases*. However, it has the disadvantage of providing a new guidance that is different from IFRS 15.
7. Option 2 maintains the current IPSAS 13, *Leases*, approach (no explicit requirements to allocate the transaction price to components of a contract). Currently, preparers rely implicitly on IPSAS 9.
8. Staff recommends Option 1. The IPSASB will remain consistent with previous decisions to include references to IPSAS 9 instead of IFRS 15 (for example: in sale and leaseback transactions).

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9. Paragraph 18 is included in mark-up in the draft Exposure Draft to reflect the staff's recommendation.

### **Decisions required**

10. Does the IPSASB agree with staff's recommendation to replace the cross-reference to IFRS 15 with IPSAS 9 (Option 1)?

## **Lessor–Lease modifications**

### **Question**

1. Whether the IPSASB agrees with staff's approach to lease modifications for lessor accounting?

### **Detail**

2. Paragraphs 79–80 of IFRS 16, *Leases*, includes requirements for lessors on lease modifications. The draft Exposure Draft on Leases proposes lease modifications requirements for lessors with the following approach:
  - (a) Retention of IFRS 16.79 in the draft Exposure Draft with minor amendments (see paragraph 74 of the draft Exposure Draft) because this guidance can be applicable to lessor accounting;
  - (b) Exclusion of IFRS 16.80 in the draft Exposure Draft because this guidance is related to IFRS 16 risks and rewards model that is not carried over to the draft Exposure Draft; and
  - (c) Use the lessee accounting requirements in IFRS 16.45–46 as a basis for lessor accounting (see paragraphs 75–76 of the draft Exposure Draft).

### **Decisions required**

3. Does the IPSASB support staff's approach to lease modifications for lessor accounting in the draft Exposure Draft?

**Sale and leaseback transactions at below market terms****Question**

1. Whether the Board agrees with the staff's recommendation on leaseback transactions at below market terms?

**Detail**

2. Paragraph 85(a) of the draft Exposure Draft on Leases provides guidance on sale and leaseback transactions at below market terms based on IFRS 16.101(a).
3. The TBG and staff have identified two mutually exclusive options on leasebacks at below market terms (IFRS 16.101(a)), as follows:
  - (a) Option 1 – The leasebacks at below market terms are accounted as in IFRS 16; or
  - (b) Option 2 – The leasebacks at below market terms are accounted as:
    - (i) A normal concessionary lease when there is evidence it has the same economic substance; and
    - (ii) In IFRS 16 if there is evidence that the transaction is not a concessionary lease.
4. In Option 2, the entity would consider the following indicators:
  - (a) The transaction may be a sale and concessionary leaseback where:
    - (i) A public sector entity has entered into a leaseback transaction with another public sector entity.
    - (ii) Entering into a contract with below market terms for the leaseback are approved/declared by government or law as subsidy.
    - (iii) Below market terms are accepted for reasons other than to compensate the service.
  - (b) The transaction may be a sale and leaseback where:
    - (i) A public sector entity has entered into a transaction with a private sector entity.
    - (ii) Public sector has entered into a transaction with public sector, but with statements by government or law that the whole transaction is an exchange transaction.
    - (iii) In the contract there is clear evidence that below-market terms are prepayments.
5. The TBG and staff have identified the following arguments in favor of Options 1 and 2:
  - (a) Option 1:
    - (i) A leaseback at below market terms is a different transaction from a concessionary lease because the leaseback at below market terms is linked to a sale in the first place, and a concessionary lease is not linked to a sale in the first place with the same party; and
    - (ii) There is no public sector specific difference that warrant a different accounting from IFRS 16;

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- (b) Option 2:
  - (i) In the public sector a leaseback below market terms is made with the purpose of giving a subsidy to the lessee; and
  - (ii) The high frequency of leases below market terms in the public sector makes the case to account leasebacks below market terms in the same way as “normal” concessionary leases.
- 6. The IPSASB's Policy Paper *Process for Reviewing and Modifying IASB Documents* (also known as “Rules of the Road”) has been considered in assessing the options.
- 7. According to the *Rules of the Road*, a modification to an IASB document is required if there is a public sector issue that warrants departure.
- 8. Staff is of the view that the arguments in favor of Option 2:
  - (a) Are not public sector specific; and
  - (b) Are based on the assumption that leasebacks at below market terms and concessionary leases are in substance the same transaction.
- 9. Staff notes that the IPSASB considered transfers between public and private sectors in developing IPSAS 40, *Public Sector Combinations*. The IPSASB did not proceed with that rationale, noting that sector classification was a Government Finance Statistics phenomenon that does not have an equivalent in IPSAS. Consequently, it would be difficult to include this in the ED (See IPSAS 40.BC4, BC5 and BC31(a)).
- 10. As leasebacks at below market terms and concessionary leases have different starting points (as explained in paragraph 5(a)(i)), they are in substance different transactions. And if they are in substance different transactions, staff is of the view that they should be accounted differently.
- 11. Furthermore, in a leaseback at below market terms it is almost impossible to know whether the price of the sale was influenced by the price of the leaseback, or vice-versa, because the leaseback is made right after the sale and with the same party.
- 12. Therefore, staff recommends the IPSASB to adopt the IFRS 16 requirements on leasebacks at below market terms.

### Decisions required

- 13. Does the IPSASB want to adopt:
  - (a) Staff's recommendation to apply the IFRS 16 accounting requirements on leasebacks at below market terms (Option 1); or
  - (b) The concessionary lease accounting requirements and the IFRS 16 accounting requirements depending on the economic substance of the sale and leaseback to leasebacks at below market terms (Option 2)?

**Lessor–Credit entry****Question**

1. Whether the IPSASB agree to:
  - (a) Present the credit entry in net assets/equity or elsewhere in the statement of financial position; and
  - (b) Label the credit entry as revenue, unearned revenue, lease unearned revenue or other obligation?

**Detail**

2. At the March 2017 meeting, the IPSASB agreed with the principle of recognizing revenue over the lease term in the statement of financial performance. However, the IPSASB did not decide on where to present the credit entry in the statement of financial position at inception of a lease. The IPSASB directed staff to assess the relationship between the Leases project and the Revenue and Non-Exchange Expenses project on the economic nature of the credit entry.
3. Staff has identified the following possible ways of recognizing the credit entry according to the Conceptual Framework:
  - (a) Liability;
  - (b) Revenue; and
  - (c) Other obligation.
4. According to the Conceptual Framework, liability, revenue, other obligations and net financial position are defined or described, as follows:

Liability:

“A present obligation of the entity for an outflow of resources that results from a past event.”<sup>5</sup>

Revenue:

“Increases in the net financial position of the entity, other than arising from ownership contributions”.<sup>6</sup>

Other obligation:

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

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<sup>5</sup> Paragraph 5.14 of the Conceptual Framework

<sup>6</sup> Paragraph 5.29 of the Conceptual Framework

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5. 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. Therefore, the unearned revenue cannot be presented as a liability in the statement of financial position.
6. The TBG and staff are of the view that the credit entry represents revenue because the lessor receives the lease payments in exchange for granting a right (the right-of-use asset) to the lessee.
7. The Conceptual Framework does not link elements to a particular financial statement. Therefore, revenue may be initially recognized in any financial statement.
8. At this stage, the options to deal with the credit entry are:
  - (a) Revenue:
    - i. Through net assets/equity; and
    - ii. Elsewhere in the statement of financial position; or
  - (b) Other obligation
    - i. Through net assets/equity; and
    - ii. Elsewhere in the statement of financial position.
9. Firstly, the IPSASB will need to decide whether the credit entry should be presented in net assets/equity or elsewhere in the statement of financial position. Secondly, the IPSASB will need to decide on the label for the credit entry as revenue, unearned revenue, lease unearned revenue or other obligation.
10. If the IPSASB initially recognizes the credit entry through net assets/equity, then the revenue would need to be subsequently recycled to the statement of financial performance as performance obligations are met. This would be similar to the existing accounting treatment of some financial instruments.
11. If the IPSASB decides to recognize the credit entry through net assets/equity, then it will need to:
  - (a) Amend IPSAS 1, *Presentation of Financial Statements* because it is not one of the four components of net assets/equity. IPSAS 32.BC33-BC34 explains why the four components of net assets/equity does not apply to the credit entry in service concessions. Staff is of the view that these conclusions are also applicable to the credit entry in leases.
  - (b) Amend IPSAS 32 so that accounting for service concession arrangements is consistent with the accounting treatment of leases (i.e., recognition in net assets/equity and subsequent recycling).
12. If the IPSASB initially recognizes the credit entry elsewhere in the statement of financial position, then the revenue will need to be subsequently reduced as revenue is recognized in the statement of financial performance. This occurs as performance obligations are satisfied.
13. If the IPSASB decides to recognize the credit entry elsewhere in the statement of financial position, then it will need to:
  - (a) Amend IPSAS 1 to include items other than assets, liabilities and net assets/equity in the statement of financial position.

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## 10.2.9

- (b) Amend IPSAS 32 so that accounting for service concession arrangements is consistent with the accounting treatment of leases (i.e., initial recognition of the credit entry (revenue, unearned revenue, lease unearned revenue or other obligation depending upon the IPSASB's decision)"—rather than a liability—elsewhere in the statement of financial position and subsequent transfer to the statement of financial performance).
14. The Conceptual Framework does not link elements to particular financial statements. Such decisions are left to standards level, and consequently the Conceptual Framework does not provide guidance on where the credit entry should be recognized.
15. In considering whether to recognize the credit entry in net assets/equity, consideration has to be given to the definition of net assets/equity in IPSAS 1:
- Net assets/equity is the residual interest in the assets of the entity after deducting all its liabilities.<sup>7</sup>
16. Some might argue that the credit entry would appear to be consistent with this definition. If the IPSASB agreed with this conclusion, the credit entry should be recognized in net assets/equity. If the IPSASB disagrees with this conclusion, the credit entry should be recognized elsewhere in the statement of financial position.
17. If the IPSASB agrees that the credit entry should be recognized in net assets/equity, paragraph 95 of IPSAS 1 is relevant:
- When an entity has no share capital, it shall disclose net assets/equity, either on the face of the statement of financial position or in the notes, showing separately:
- (a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;
  - (b) Accumulated surpluses or deficits;
  - (c) Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and
  - (d) Non-controlling interests.
18. Arguably, the credit entry could fit within the reserves category as a sub-category.
19. Consequently, the IPSASB would need to decide whether to extend the use of the reserves category, or to include an additional category.
20. Some TBG members are of the view that it is not appropriate to recognize the credit entry in net assets/equity because the lessor has a present obligation to make the underlying asset available to the lessee. The existence of this present obligation makes the case to conclude that the credit entry does not represent a direct increase in the grantor's net assets/equity.
21. The IPSASB will also need to decide on the label for the credit entry, regardless of where that credit entry is recognized. As noted above, the options are revenue, unearned revenue, lease unearned revenue or other obligation.

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<sup>7</sup> IPSAS 1.7



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22. Staff considers that unearned revenue best describes the nature of the entry and has used this label in the draft Exposure Draft.

### *Relationship with the IPSASB's Revenue and Non-Exchange Expenses project*

23. The IPSASB currently has a project on Revenue and Non-Exchange Expenses. The project deals with all revenue transactions, both exchange and non-exchange transactions. For exchange revenue transactions, the IPSASB is proposing to follow the performance obligation approach that it is in IFRS 15, *Revenue from Contracts with Customers*. For non-exchange transactions, the IPSASB is proposing to either, follow the guidance in IPSAS 23 with some amendments or to extend the IFRS 15 performance obligation approach to address public sector specific issues. In both approaches, the recognition of revenue is deferred until the performance obligation is met (which may be at a point of time or over time).
24. For transactions that have time requirement restrictions, the Board is proposing four options to revise IPSAS 23:
- (a) Requiring enhanced presentation (either display, disclosure or both) to communicate that some transfers are restricted. This option would not result in a deferral of revenue recognition;
  - (b) Classify a time requirement restriction as a condition (as per IPSAS 23). This option would defer revenue recognition;
  - (c) Recognize the transfer in net assets/equity and recycle through the statement of financial performance when the time requirement is met. This option would defer revenue recognition; or
  - (d) Treat a transfer with a time requirement restriction as an 'other obligation'. This option would defer revenue recognition.
25. The options identified in paragraphs 24(c) and 24(d) are coincident with the options provided in this Issues Paper (see paragraphs 8–22) for lessor accounting.
26. The IPSASB will need to consider the implications of decisions in the Revenue and Non-Exchange project in the Leases project.
27. Staff notes that in the draft Exposure Draft on Leases (Agenda Item 7.4) the credit entry is labelled as "unearned revenue". This term might change depending on IPSASB's decision in this Agenda Item.

### **Decision required**

28. Where does the IPSASB want to present the credit entry in the statement of financial position and what label should be used?

**Lessor–Measurement****Question**

1. Whether the IPSASB agree with staff's approach on measurement in lessor accounting?

**Detail**

2. This Issues Paper provides an explanation of staff's approach to the main issues on measurement in lessor accounting and is structured following the sequence in the draft Exposure Draft on Leases.
3. The issues are presented on an exception basis according to the amendments to IFRS 16. Where the proposed accounting requirements are based on IFRS 16, staff has not identified a public sector specific reason that warrant departure from IFRS 16 nor it does not contradict IPSASB's previous decisions on lessor accounting.
4. Staff notes that this section of the issues paper should read together with the draft Exposure Draft on Leases.

*Initial measurement of the lease receivable*

5. The lease receivable is initially measured at the present value of the lease payments that are not received at that date.
6. Paragraphs 57-60 of the draft Exposure Draft set out the requirements, which mirror the requirements of lessee accounting to the extent possible. Additional guidance for concessionary leases is provided.

*Initial measurement of the unearned revenue*

7. Paragraph 61 of the draft Exposure Draft on Leases proposes to initially measure the unearned revenue at the initial value of the lease receivable in order to ensure the same entries as for the lease receivable in lessor's accounts.

*Subsequent measurement of the lease receivable*

8. Paragraphs 62 and 71 of the draft Exposure Draft on Leases mirrors the requirements of lessee accounting to the extent possible. Additional guidance for concessionary leases and derecognition and impairment of the lease receivable is provided.

*Subsequent measurement of the unearned revenue*

9. Paragraph 72 of the draft Exposure Draft on Leases draft proposes to recognize revenue according to the substance of the lease contract. This approach is consistent with IPSAS 32 for service concession arrangements.
10. Paragraph 73 of the draft Exposure Draft on Leases ensures that the unearned revenue is adjusted by any remeasurement of the lease receivable.
11. Paragraph AG59 of the draft Exposure Draft on Leases provides guidance on the subsequent measurement of the unearned revenue consistent with IPSAS 32.AG47.

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## *Lease modifications*

12. Paragraphs 74–76 of the draft Exposure Draft on Leases mirrors the requirements for lessee accounting in the draft Exposure Draft, to the extent possible.

## *Underlying asset*

13. Paragraph 77 of the draft Exposure Draft requires a lessor to continue measuring the underlying asset in accordance with IPSAS 16, IPSAS 17 or IPSAS 31, as appropriate.
14. At the March 2017 meeting, the IPSASB agreed to continue to recognize the underlying asset in its entirety in lessor's accounts. This means that the underlying asset can continue applying the cost model for measurement after recognition that exists in the above Standards, i.e., the underlying asset is carried at its cost, less any accumulated depreciation and any accumulated impairment losses.
15. [Appendix A](#) below shows an illustrative example for recognition and measurement in lessor accounting by applying the cost model.
16. However, the IPSASB did not decide on the consequential amendments to those Standards by using a fair value measurement basis in order to avoid double-counting<sup>8</sup>.
17. As planned in the [project roadmap](#), the consequential amendments to other IPSASs are to be addressed in the September 2017 meeting.
18. Staff will also bring the issue on subsequent measurement of the underlying asset to the September 2017 meeting because:
  - (a) Subsequent measurement of the underlying asset is within the scope of other IPSASs;
  - (b) IFRS 16 introduced extensive consequential amendments to other IFRSs, including IAS 16, *Property, Plant and Equipment* and IAS 40, *Investment Property* (from which IPSAS 16 and IPSAS 17 are, respectively, primarily drawn) that needs to be assessed for public sector financial reporting; and
  - (c) The IPSASB is proposing in the Exposure Draft different lessor accounting requirements from IFRS 16 that needs to be assessed its impact in other IPSASs together with the IFRS 16 amendments.

## *Sublease*

19. The draft Exposure Draft on Leases provides additional guidance on subleases that does not exist in IFRS 16 (see paragraphs AG60 and AG61). As the draft Exposure Draft on leases proposes a single right-of-use model for lease accounting, these paragraphs will ensure that the intermediate lessor should account for the head lease and the sublease as two separate transactions, as a lessee and as a lessor, respectively, and that it should not be offset against one another.

## **Decision required**

20. Does the IPSASB agree with the requirements in:

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<sup>8</sup> In IPSAS 16, it is called fair value model, and in IPSAS 17 and IPSAS 31 it is called revaluation model.

## **Agenda Item 10.2.10**

- (a) Initial measurement of the lease receivable (see paragraphs 57–60 of the draft Exposure Draft on Leases)?
- (b) Initial measurement of the unearned revenue (see paragraph 61 of the draft Exposure Draft on Leases)?
- (c) Subsequent measurement of the lease receivable (see paragraphs 62–71 of the draft Exposure Draft on Leases)?
- (d) Subsequent measurement of the unearned revenue (see paragraphs 72–73 of the draft Exposure Draft on Leases)?
- (e) Lease modifications (see paragraphs 74–76 of the draft Exposure Draft on Leases)?
- (f) Underlying asset (see paragraphs 77 of the draft Exposure Draft on Leases)?
- (g) Sublease (see paragraphs AG60–AG61 of the draft Exposure Draft on Leases)?

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## Appendix A – Illustrative example for recognition and measurement in lessor accounting by applying the cost model

### Assumptions:

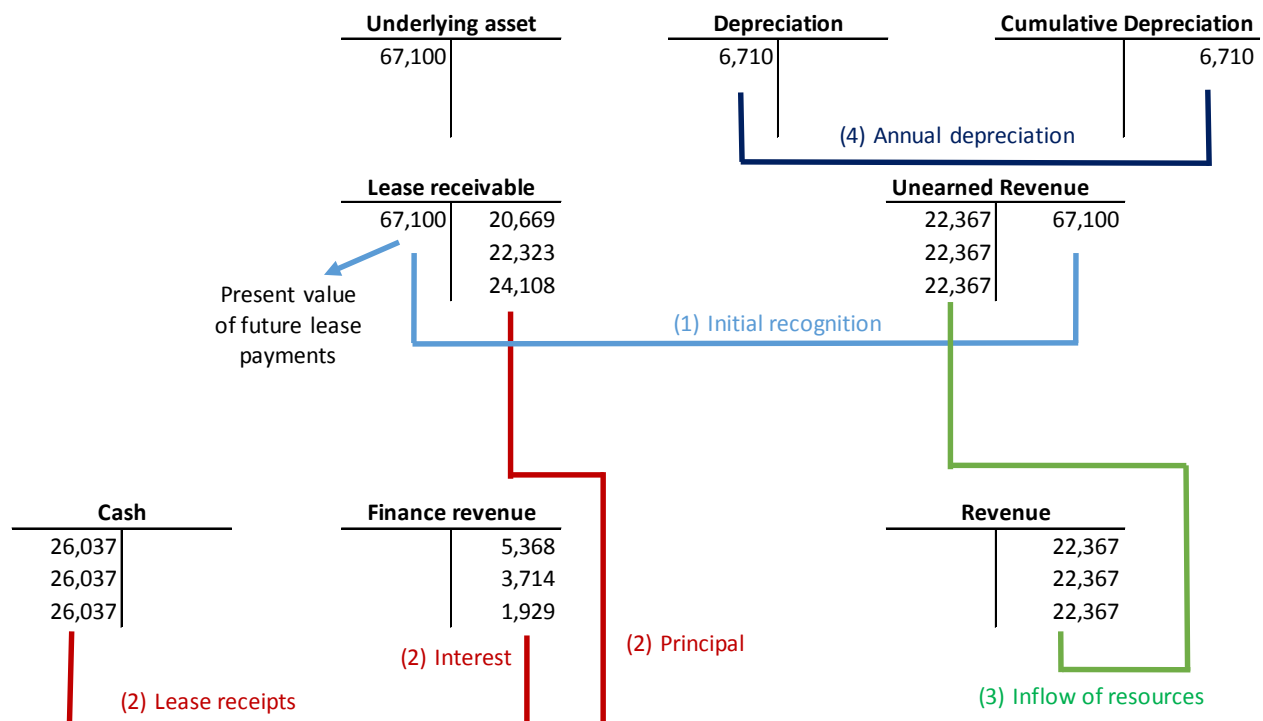
Value of the underlying asset: 67.100 CU

Total lease payments: 78.111 CU

Interest rate: 8%

Lease term: 3 years

### T-accounts



## Exposure Draft Development—Process

### Project to Maintain IASB Convergence

14. The IPSASB approved the Leases project in June 2016. At the June 2016 meeting, the IPSASB decided to maintain convergence with IFRS 16, *Leases*, to the extent possible.
15. Therefore, IFRS 16 is used as the basis for developing the Exposure Draft, *Leases*. Changes to IFRS 16 are reflected in the Exposure Draft in mark up. A marked-up draft of the Exposure Draft is included in Agenda Item 10.4.
16. The modifications to IFRS 16 were incorporated to reflect:
  - (a) Adaptations to terminology – [see Agenda Item 10.2.2](#)
  - (b) Replacement of reference to IFRSs with IPSASs.
17. The following sections of IFRS 16 are included in the ED without amendments as a result of:
  - (a) Previous IPSASB's decisions:
    - (i) Lease term – [ED 19–22]
    - (ii) Lessee: Recognition – [ED 23]
    - (iii) Lessee: Recognition Exemptions – [ED 6–9, AG4–AG9]
    - (iv) Lessee: Measurement – [ED 24, 27, 28, 29, 31, 32, 33–40, 42–43, 44–51]
    - (v) Separating components of a contract – [ED 13–18, AG33–AG34]
    - (vi) Lease term – [ED 19–22, AG35–AG42]
    - (vii) Sale and leaseback transactions – [ED 82–84, 85(b) and 86–87]
  - (b) Staff's recommendations at the June 2017 meeting:
    - (i) Identifying a lease, in-substance fixed lease payments, and lessee involvement with the underlying asset before the commencement date – [see Agenda Item 10.2.5](#) [ED 10–12, AG10–32, AG48–AG52, AG53(partial)]
    - (ii) Sale and leaseback transactions at below market terms see [Agenda Item 10.2.9](#) [ED 85(a)]

### Public Sector Specific Modifications

18. The draft ED includes the following public sector specific guidance, as follows:
  - (a) Previous IPSASB's decisions:
    - (i) Inclusion of measurement at fair value for concessionary leases (non-exchange transactions) – [ED 25, 26, 30, 41]

# Agenda Item 10.3

- (ii) Inclusion of recognition of lease receivable and credit entry (unearned revenue<sup>9</sup>) – [ED 56]
  - (iii) Inclusion of requirements on measurement in lessor accounting – [ED 57–77, AG59–61]
  - (iv) Inclusion of specific guidance on leases that are cancelled on an annual basis for budgetary reasons – [ED AG43]
  - (v) Inclusion of specific guidance on concessionary leases – [ED AG44–AG47]
  - (vi) Removal of paragraphs on IFRS 16 lessor accounting – [IFRS 16.61–67, 75–78, 80–87, B53–58]
- (b) Staff's recommendations at the June 2017 meeting:
- (i) Modifications to Objective, Scope and Definitions – [see Agenda Item 10.2.3](#) [ED 1–5, AG3]
  - (ii) Inclusion of recognition exemptions in lessor accounting– [see Agenda Item 10.2.4](#) [ED 6–9, AG4–AG9]
  - (iii) Inclusion of guidance on subleases – [see Agenda Item 10.2.11](#) [ED AG60–AG61]
  - (iv) Removal of IFRS 16 paragraphs on manufacturer or dealer lessor – see [Agenda Item 10.2.6](#) [IFRS 16.71–74, AG53(partial)]
19. The ED on Leases also includes Illustrative Examples drawn from IFRS 16 and on concessionary leases that will be discussed and reviewed at the September 2017 meeting, as per the [project roadmap](#).

## Review of Draft Exposure Draft, *Leases*

20. The IPSASB is asked to review the following sections of the draft Exposure Draft, *Leases*:
- (a) Objective (ED 1–2);
  - (b) Scope (ED 3–4);
  - (c) Definitions (ED 5);
  - (d) Recognition Exemptions (ED 7–9);
  - (e) Identifying a lease (ED 10–18);
  - (f) Lease term (ED 19–22);
  - (g) Lessee (ED 23–51);
  - (h) Lessor (ED 56–77);
  - (i) Sale and leaseback transactions (ED 82–87);
  - (j) Withdrawal and replacement of IPSAS 13 (December 2001) (ED 108);
  - (k) Application guidance (ED AG1–AG61); and

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<sup>9</sup> The term “unearned revenue” will be discussed in the [Agenda Item 10.2.9](#).

## **Agenda Item 10.3**

- (l) Basis for conclusions (ED BC1–BC42; BC45–BC47; BC51–BC56).



Exposure Draft  
[Issued]  
*Comments due: [Date]*

*Proposed International Public Sector Accounting  
Standard®*

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## Leases

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

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## REQUEST FOR COMMENTS

This Exposure Draft, *Leases*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by [DATE].**

Respondents are asked to submit their comments electronically through the IPSASB website, using the [“Submit a Comment”](#) link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### Objective of the Exposure Draft

The objective of this Exposure Draft is to propose improvements to lease accounting in order to ensure that lessees and lessors provide relevant information in a manner that faithfully represents leasing transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity for accountability and decision-making purposes.

### Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

The Specific Matters for Comment requested for the Exposure Draft are provided below.

**Specific Matter for Comment 1:**

**Specific Matter for Comment 2:**

**Specific Matter for Comment 3:**

**Specific Matter for Comment 4:**

**Specific Matter for Comment 5:**

**Specific Matter for Comment 6:**

**Specific Matter for Comment 7:**

**[DRAFT] IPSAS [X] (ED [X])—LEASES****CONTENTS**


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## Objective

1. This [draft] Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity for accountability and decision-making purposes.
2. An entity shall consider the terms and conditions of contracts and all relevant facts and circumstances when applying this [draft] Standard. An entity shall apply this [draft] Standard consistently to contracts with similar characteristics and in similar circumstances.

## Scope

3. An entity shall apply this [draft] Standard to all leases, including leases of right-of-use assets in a sublease, except for:
  - (a) Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources;
  - (b) Leases of biological assets within the scope of ~~IAS 41, Agriculture~~ IPSAS 27, Agriculture;
  - (c) Service concession arrangements within the scope of ~~IFRIC 12, Service Concession Arrangements~~ IPSAS 32, Service Concession Arrangements: Grantor;
  - (d) Licenses of intellectual property granted by a lessor within the scope of ~~IFRS 15, Revenue from Contracts with Customers~~ IPSAS 9, Revenue from Exchange Transactions; and
  - (e) Rights held by a lessee under licensing agreements within the scope of ~~IAS 38, Intangible Assets~~ IPSAS 31, Intangible Assets for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights; and
  - (f) Leases for zero or nominal consideration. The portion of the lease that is payable, if any, along with any interest payment is within scope of this [draft] Standard.
4. A lessee may, but is not required to, apply this Standard to leases of intangible assets other than those described in paragraph 3(e).

## Definitions (see paragraph AG3)

5. The following terms are used in this Standard with the meanings specified:

The commencement date of the lease (commencement date) is the date on which a lessor makes an underlying asset available for use by a lessee.

A contract is an agreement between two or more parties that creates enforceable rights and obligations.

Economic life is either:

- (a) The period over which an asset is expected to be economically usable by one or more users; or

- (b) **The number of production or similar units expected to be obtained from an asset by one or more users.**

**The effective date of the modification is the date when both parties agree to a lease modification.**

**Fixed payments are payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.**

**The inception date of the lease (inception date) is the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease.**

**Initial direct costs are incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained.**

**The interest rate implicit in the lease is the rate of interest that causes the present value of the lease payments to equal the sum of (i) the fair value of the underlying asset and (ii) any initial direct costs of the lessor.**

**A lease is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.**

**Lease incentives are payments made by a lessor to a lessee associated with a lease, or the reimbursement or assumption by a lessor of costs of a lessee.**

**Lease modification is a change in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for example, adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).**

**Lease payments are payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:**

- (a) **Fixed payments (including in-substance fixed payments), less any lease incentives;**
- (b) **Variable lease payments that depend on an index or a rate;**
- (c) **The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and**
- (d) **Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.**

**For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees. Lease payments do not include payments allocated to non-lease components of a contract, unless the lessee elects to combine non-lease components with a lease component and to account for them as a single lease component.**

**For the lessor, lease payments also include any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. Lease payments do not include payments allocated to non-lease components.**

The **lease term** is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

- (a) Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
- (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

A **lessee** is an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

The **lessee's incremental borrowing rate** is the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

A **lessor** is an entity that provides the right to use an underlying asset for a period of time in exchange for consideration.

**Optional lease payments** are payments to be made by a lessee to a lessor for the right to use an underlying asset during periods covered by an option to extend or terminate a lease that are not included in the lease term.

**Period of use** is the total period of time that an asset is used to fulfil a contract with a customer (including any non-consecutive periods of time).

The **residual value guarantee** is a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

A **right-of-use asset** is an asset that represents a lessee's right to use an underlying asset for the lease term.

A **short-term lease** is a lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease.

A **sublease** is a transaction for which an underlying asset is re-leased by a lessee ('intermediate lessor') to a third party, and the lease ('head lease') between the head lessor and lessee remains in effect.

**Underlying asset** is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

**Unguaranteed residual value** is that portion of the residual value of the underlying asset, the realization of which by a lessor is not assured or is guaranteed solely by a party related to the lessor.

**Variable lease payments** are the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately. The



**defined term useful life is used in this Standard with the meaning as in IPSAS 17, *Property, Plant, and Equipment*.**

### **Recognition Exemptions (see paragraphs AG4–AG9)**

6. A lessee or a lessor may elect not to apply the requirements, respectively, in paragraphs 23–XX and paragraphs 56–XX to:
  - (a) Short-term leases; and
  - (b) Leases for which the underlying asset is of low value (as described in paragraphs AG4–AG9).
7. If a lessee or a lessor elects not to apply the requirements, respectively, in paragraphs 23–XX and paragraphs 56–XX to either short-term leases or leases for which the underlying asset is of low value, the lessee shall recognize the lease payments associated with those leases as an expense on either a straight-line basis over the lease term or another systematic basis, and the lessor shall recognize the lease payments associated with those leases as a revenue on either a straight-line basis over the lease term or another systematic basis. The lessee or lessor shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit or lessor's benefit.
8. If a lessee or a lessor accounts for short-term leases applying paragraph 7, the lessee or lessor shall consider the lease to be a new lease for the purposes of this Standard if:
  - (a) There is a lease modification; or
  - (b) There is any change in the lease term (for example, the lessee exercises an option not previously included in its determination of the lease term).
9. The election for short-term leases shall be made by class of underlying asset to which the right of use relates. A class of underlying asset is a grouping of underlying assets of a similar nature and use in an entity's operations. The election for leases for which the underlying asset is of low value can be made on a lease-by-lease basis.

### **Identifying a Lease (see paragraphs AG10–AG34)**

10. **At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Paragraphs AG10–AG32 set out guidance on the assessment of whether a contract is, or contains, a lease.**
11. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce).
12. An entity shall reassess whether a contract is, or contains, a lease only if the terms and conditions of the contract are changed.

### **Separating Components of a Contract**

13. 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 16. Paragraphs AG33–AG34 set out guidance on separating components of a contract.

*Lessee*

14. 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.
15. 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.
16. 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*.
17. Unless the practical expedient in paragraph 16 is applied, a lessee shall account for non-lease components applying other applicable Standards.

*Lessor*

18. For a contract that contains a lease component and one or more additional lease or non-lease components, a lessor shall allocate the consideration in the contract applying ~~paragraphs 73–90 of IFRS 15~~ IPSAS 9, *Revenue from Exchange Transactions*.

**Lease Term (see paragraphs AG35–AG43)**

19. 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
  - (b) Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.
20. 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 AG38–AG41.
21. 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 AG42).

22. 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

23. **At the commencement date, a lessee shall recognize a right-of-use asset and a lease liability.**

### Measurement

#### *Initial Measurement*

#### Initial Measurement of the Right-of-Use Asset

24. **At the commencement date, a lessee shall measure the right-of-use asset at cost.**
25. **Where a right-of-use asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the commencement date.**
26. A right-of-use asset may be acquired through a non-exchange transaction. For example, property may be leased by a public sector entity at below fair value to implement a public policy. Under these circumstances, the cost of the item is its fair value as at the commencement date.
27. The cost of the right-of-use asset shall comprise:
- (a) The amount of the initial measurement of the lease liability, as described in paragraph 29;
  - (b) Any lease payments made at or before the commencement date, less any lease incentives received;
  - (c) Any initial direct costs incurred by the lessee; and
  - (d) An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.
28. A lessee shall recognize the costs described in paragraph 27(d) as part of the cost of the right-of-use asset when it incurs an obligation for those costs. A lessee applies ~~IAS 2~~ IPSAS 12, Inventories to costs that are incurred during a particular period as a consequence of having used the right-of-use

asset to produce inventories during that period. The obligations for such costs accounted for applying this Standard or ~~IAS 2~~ IPSAS 12 are recognized and measured applying ~~IAS 37~~ IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

#### Initial Measurement of the Lease Liability

29. **At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.**
30. **Where a lease liability is recognized through a non-exchange transaction, its cost shall be measured at its fair value as at the commencement date.**
31. At the commencement date, the lease payments included in the measurement of the lease liability comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:
  - (a) Fixed payments (including in-substance fixed payments as described in paragraph AG48), less any lease incentives receivable;
  - (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date (as described in paragraph 32);
  - (c) Amounts expected to be payable by the lessee under residual value guarantees;
  - (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG38–AG41); and
  - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.
32. Variable lease payments that depend on an index or a rate described in paragraph 31(b) include, for example, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as LIBOR) or payments that vary to reflect changes in market rental rates.

#### *Subsequent Measurement*

##### Subsequent Measurement of the Right-of-Use Asset

33. **After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies either of the measurement models described in paragraphs 38 and 39.**

##### Cost Model

34. To apply a cost model, a lessee shall measure the right-of-use asset at cost:
  - (a) Less any accumulated depreciation and any accumulated impairment losses; and
  - (b) Adjusted for any remeasurement of the lease liability specified in paragraph 40(c).
35. A lessee shall apply the depreciation requirements in ~~IAS 16~~ IPSAS 17, *Property, Plant and Equipment* in depreciating the right-of-use asset, subject to the requirements in paragraph 36.

36. 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.
37. A lessee shall apply ~~IAS 36 Impairment of Assets~~ IPSAS 26, *Impairment of Cash-Generating Assets* to determine whether the right-of-use asset is impaired and to account for any impairment loss identified.

#### Other Measurement Models

38. If a lessee applies the fair value model in ~~IAS 40~~ IPSAS 16, *Investment Property* to its investment property, the lessee shall also apply that fair value model to right-of-use assets that meet the definition of investment property in ~~IAS 40~~ IPSAS 16.
39. If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in ~~IAS 16~~ IPSAS 17, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.

#### Subsequent Measurement of the Lease Liability

40. **After the commencement date, a lessee shall measure the lease liability by:**
  - (a) **Increasing the carrying amount to reflect interest on the lease liability;**
  - (b) **Reducing the carrying amount to reflect the lease payments made; and**
  - (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 44–51, or to reflect revised in-substance fixed lease payments (see paragraph AG48).**
41. **After the commencement date, a lessee shall measure the lease liability recognized through a non-exchange transaction at amortized cost using the effective interest method.**
42. Interest on the lease liability in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease liability. The periodic rate of interest is the discount rate described in paragraph 29, or if applicable the revised discount rate described in paragraph 46, paragraph 48 or paragraph 50(c).
43. After the commencement date, a lessee shall recognize in ~~profit surplus~~ or ~~loss deficit~~, unless the costs are included in the carrying amount of another asset applying other applicable Standards, both:
  - (a) Interest on the lease liability; and
  - (b) Variable lease payments not included in the measurement of the lease liability in the period in which the event or condition that triggers those payments occurs.

#### Reassessment of the Lease Liability

44. After the commencement date, a lessee shall apply paragraphs 45–48 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 profit surplus or loss deficit.

45. 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 21–22. 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 21–22 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.
46. In applying paragraph 45, 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.
47. 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 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.
48. In applying paragraph 47, 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

49. 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.
50. 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 14–17;

- (b) Determine the lease term of the modified lease applying paragraphs 19–20; 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.
51. 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 profit surplus or loss 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.

## Presentation

52. [To be discussed at the September 2017 meeting]
53. [To be discussed at the September 2017 meeting]

## Disclosure

54. [To be discussed at the September 2017 meeting]
55. [To be discussed at the September 2017 meeting]

## Lessor

### **Classification of leases (paragraphs B53–B58)**

- ~~61. A lessor shall classify each of its leases as either an operating lease or a finance lease.~~
- ~~62. 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.~~
- ~~63. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:~~
- ~~(a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;~~
  - ~~(b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;~~
  - ~~(c) the lease term is for the major part of the economic life of the underlying asset even if title is not transferred;~~

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- (d) ~~at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and~~
  - (e) ~~the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.~~
64. ~~Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:~~
- (a) ~~if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;~~
  - (b) ~~gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and~~
  - (c) ~~the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.~~
65. ~~The examples and indicators in paragraphs 63–64 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset, the lease is classified as an operating lease. For example, this may be the case if ownership of the underlying asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are variable lease payments, as a result of which the lessor does not transfer substantially all such risks and rewards.~~
66. ~~Lease classification is made at the inception date and is reassessed only if there is a lease modification. Changes in estimates (for example, changes in estimates of the economic life or of the residual value of the underlying asset), or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.~~

## **Finance leases**

### **Recognition and measurement**

67. ~~At the commencement date, a lessor shall recognise assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease.~~

### **Recognition**

56. **At the commencement date, a lessor shall recognize a lease receivable and unearned revenue. A lessor shall not derecognize the underlying asset.**

### **Measurement**

#### *Initial Measurement*

#### Initial Measurement of the Lease Receivable

57. ~~The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease receivable.~~ **At the commencement date, a lessor shall measure the lease receivable at the present value of the lease payments that are not received at that date. The lease payments**



**shall be discounted using the interest rate implicit in the lease. In the case of a sublease, if the interest rate implicit in the sublease cannot be readily determined, an intermediate lessor may use the discount rate used for the head lease (adjusted for any initial direct costs associated with the sublease) to measure the net investment in the sublease lease receivable.**

58. **Where a lease receivable is recognized through a non-exchange transaction, its cost shall be measured at its fair value as at the commencement date.**
59. Initial direct costs, ~~other than those incurred by manufacturer or dealer lessors,~~ are included in the initial measurement of the ~~net investment in the lease~~ lease receivable and reduce the amount of ~~income revenue~~ recognized over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the ~~net investment in the lease~~ lease receivable; there is no need to add them separately.

~~Initial measurement of the lease payments included in the net investment in the lease~~

60. At the commencement date, the lease payments included in the measurement of the ~~net investment in the lease~~ lease receivable comprise the following payments for the right to use the underlying asset during the lease term that are not received at the commencement date:
- (a) Fixed payments (including in-substance fixed payments as described in paragraph AG48), less any lease incentives receivable;
  - (b) Variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
  - (c) Any residual value guarantees provided to the lessor by the lessee, a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee;
  - (d) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option (assessed considering the factors described in paragraphs AG38); and
  - (e) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

Initial Measurement of the Unearned Revenue

61. At the commencement date, a lessor shall measure the unearned revenue at the initial value of the lease receivable.

~~Manufacturer or dealer lessor~~

71. ~~At the commencement date, a manufacturer or dealer lessor shall recognize the following for each of its finance leases:~~
- (a) ~~Revenue being the fair value of the underlying asset, or, if lower, the present value of the lease payments accruing to the lessor, discounted using a market rate of interest;~~
  - (b) ~~The cost of sale being the cost, or carrying amount if different, of the underlying asset less the present value of the unguaranteed residual value; and~~

- (c) ~~Selling profit or loss (being the difference between revenue and the cost of sale) in accordance with its policy for outright sales to which IFRS 15 applies. A manufacturer or dealer lessor shall recognise selling profit or loss on a finance lease at the commencement date, regardless of whether the lessor transfers the underlying asset as described in IFRS 15.~~

~~72. Manufacturers or dealers often offer to customers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or dealer lessor gives rise to profit or loss equivalent to the profit or loss resulting from an outright sale of the underlying asset, at normal selling prices, reflecting any applicable volume or trade discounts.~~

~~73. Manufacturer or dealer lessors sometimes quote artificially low rates of interest in order to attract customers. The use of such a rate would result in a lessor recognising an excessive portion of the total income from the transaction at the commencement date. If artificially low rates of interest are quoted, a manufacturer or dealer lessor shall restrict selling profit to that which would apply if a market rate of interest were charged.~~

~~74. A manufacturer or dealer lessor shall recognise as an expense costs incurred in connection with obtaining a finance lease at the commencement date because they are mainly related to earning the manufacturer or dealer's selling profit. Costs incurred by manufacturer or dealer lessors in connection with obtaining a finance lease are excluded from the definition of initial direct costs and, thus, are excluded from the net investment in the lease.~~

#### *Subsequent Measurement*

~~75. A lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.~~

~~76. A lessor aims to allocate finance income over the lease term on a systematic and rational basis. A lessor shall apply the lease payments relating to the period against the gross investment in the lease to reduce both the principal and the unearned finance income.~~

~~77. A lessor shall apply the derecognition and impairment requirements in IFRS 9 to the net investment in the lease. A lessor shall review regularly estimated unguaranteed residual values used in computing the gross investment in the lease. If there has been a reduction in the estimated unguaranteed residual value, the lessor shall revise the income allocation over the lease term and recognise immediately any reduction in respect of amounts accrued.~~

~~78. A lessor that classifies an asset under a finance lease as held for sale (or includes it in a disposal group that is classified as held for sale) applying IFRS 5 Non-current Assets Held for Sale and Discontinued Operations shall account for the asset in accordance with that Standard.~~

#### Subsequent Measurement of the Lease Receivable

62. **After the commencement date, a lessor shall measure the lease receivable by:**

- (a) **Increasing the carrying amount to reflect interest on the lease receivable;**
- (b) **Reducing the carrying amount to reflect the lease payments received; and**
- (c) **Remeasuring the carrying amount to reflect any reassessment or lease modifications specified in paragraphs 67–76, or to reflect revised in-substance fixed lease payments (see paragraph AG48).**

63. **After the commencement date, a lessor shall measure the lease receivable recognized through a non-exchange transaction at amortized cost using the effective interest method.**
64. Interest on the lease receivable in each period during the lease term shall be the amount that produces a constant periodic rate of interest on the remaining balance of the lease receivable. The periodic rate of interest is the discount rate described in paragraph 57, or if applicable the revised discount rate described in paragraph 69, paragraph 71 or paragraph 75(c).
65. After the commencement date, a lessor shall recognize in surplus or deficit both:
- (a) Interest on the lease receivable; and
  - (b) Variable lease payments not included in the measurement of the lease receivable in the period in which the event or condition that triggers those payments occurs.
66. After the commencement date, a lessor shall apply the derecognition and impairment requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement* to the lease receivable.

#### Reassessment of the Lease Receivable

67. After the commencement date, a lessor shall apply paragraphs 68–71 to remeasure the lease receivable to reflect changes to the lease payments. A lessor shall recognize the amount of the remeasurement of the lease receivable as an adjustment to the unearned revenue. However, if the carrying amount of the unearned revenue is reduced to zero and there is a further reduction in the measurement of the lease receivable, a lessor shall recognize any remaining amount of the remeasurement in surplus or deficit.
68. A lessor shall remeasure the lease receivable 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 22. A lessor 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 22 in the context of a purchase option. A lessor shall determine the revised lease payments to reflect the change in amounts payable under the purchase option.
69. In applying paragraph 68, a lessor shall determine the revised discount rate as the interest rate implicit in the lease for the remainder of the lease term.
70. A lessor 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 lessor 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 market rental rates following a market rent review. The lessor shall remeasure the lease receivable 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 lessor shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments.

71. In applying paragraph 70, a lessor shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessor shall use a revised discount rate that reflects changes in the interest rate.

#### Subsequent Measurement of the Unearned Revenue

72. **After the commencement date, a lessor shall recognize revenue according to the substance of the lease contract, and the unearned revenue is reduced as revenue is recognized in the statement of financial performance.**
73. A lessor shall adjust the unearned revenue by the same amount as the change resulting from the remeasurement of the lease receivable.

#### Lease Modifications

74. A lessor shall account for a ~~modification to a finance 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.
- ~~80. For a modification to a finance lease that is not accounted for as a separate lease, a lessor shall account for the modification as follows:~~
- ~~(a) If the lease would have been classified as an operating lease had the modification been in effect at the inception date, the lessor shall:~~
    - ~~(i) Account for the lease modification as a new lease from the effective date of the modification; and~~
    - ~~(ii) Measure the carrying amount of the underlying asset as the net investment in the lease immediately before the effective date of the lease modification.~~
  - ~~(b) Otherwise, the lessor shall apply the requirements of IFRS 9.~~
75. For a lease modification that is not accounted for as a separate lease, at the effective date of the lease modification a lessor shall:
- (a) Allocate the consideration in the modified contract applying paragraph 18;
  - (b) Determine the lease term of the modified lease applying paragraphs 19–20; and
  - (c) Remeasure the lease receivable 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.
76. For a lease modification that is not accounted for as a separate lease, the lessor shall account for the remeasurement of the lease receivable by:
- (a) Decreasing the carrying amount of the unearned revenue to reflect the partial or full termination of the lease for lease modifications that decrease the scope of the lease. The lessor shall

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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 unearned revenue for all other lease modifications.

Underlying Asset

77. After the commencement date, a lessor continues to measure the underlying asset in accordance with IPSAS 16, IPSAS 17 or IPSAS 31 as appropriate.

**Operating leases**

*Recognition and measurement*

- ~~81 A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.~~
- ~~82 A lessor shall recognise costs, including depreciation, incurred in earning the lease income as an expense.~~
- ~~83 A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.~~
- ~~84 The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with IAS 16 and IAS 38.~~
- ~~85 A lessor shall apply IAS 36 to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.~~
- ~~86 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.~~

*Lease modifications*

- ~~87 A lessor shall account for a modification to an operating lease as a new lease from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease.~~

**Presentation**

78. [To be discussed at the September 2017 meeting]
79. [To be discussed at the September 2017 meeting]

**Disclosure**

80. [To be discussed at the September 2017 meeting]
81. [To be discussed at the September 2017 meeting]

## Sale and Leaseback Transactions

82. 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 88–92.

### *Assessing Whether the Transfer of the Asset is a Sale*

83. 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

84. 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.
85. 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.
86. The entity shall measure any potential adjustment required by paragraph 90 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.

### Transfer of the Asset is not a Sale

87. 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*<sup>1</sup>.

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<sup>1</sup> 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*.

- (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.

## **Effective Date and Transition**

### **Effective Date**

88. [To be discussed at the September 2017 meeting]

### **Transition**

89. [To be discussed at the September 2017 meeting]  
90. [To be discussed at the September 2017 meeting]

### *Definition of a Lease*

91. [To be discussed at the September 2017 meeting]  
92. [To be discussed at the September 2017 meeting]

### *Lessees*

93. [To be discussed at the September 2017 meeting]  
94. [To be discussed at the September 2017 meeting]  
95. [To be discussed at the September 2017 meeting]

### *Leases Previously Classified as Operating Leases*

96. [To be discussed at the September 2017 meeting]  
97. [To be discussed at the September 2017 meeting]  
98. [To be discussed at the September 2017 meeting]

### *Leases Previously Classified as Finance Leases*

99. [To be discussed at the September 2017 meeting]

### *Disclosure*

100. [To be discussed at the September 2017 meeting]  
101. [To be discussed at the September 2017 meeting]

### *Lessors*

102. [To be discussed at the September 2017 meeting]  
103. [To be discussed at the September 2017 meeting]

### *Sale and Leaseback Transactions before the Date of Initial Application*

104. [To be discussed at the September 2017 meeting]

105. [To be discussed at the September 2017 meeting]

106. [To be discussed at the September 2017 meeting]

*Amounts Previously Recognized in Respect of Public Sector Combinations*

107. [To be discussed at the September 2017 meeting]

### **Withdrawal and Replacement of IPSAS 13 (December 2001)**

108. This Standard supersedes IPSAS 13, *Leases*, issued in 2001.



## Application Guidance

*This Appendix is an integral part of [draft] IPSAS [X] (ED [X])*

### Portfolio Application

AG1. This Standard specifies the accounting for an individual lease. However, as a practical expedient, an entity may apply this Standard to a portfolio of leases with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual leases within that portfolio. If accounting for a portfolio, an entity shall use estimates and assumptions that reflect the size and composition of the portfolio.

### Combination of Contracts

AG2. In applying this Standard, an entity shall combine two or more contracts entered into at or near the same time with the same counterparty (or related parties of the counterparty), and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) The contracts are negotiated as a package with an overall commercial objective that cannot be understood without considering the contracts together;
- (b) The amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) The rights to use underlying assets conveyed in the contracts (or some rights to use underlying assets conveyed in each of the contracts) form a single lease component as described in paragraph AG33.

### Definitions (see paragraph 5)

AG3. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a "contract" for purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):

- (a) Contracts involve willing parties entering into an arrangement;
- (b) The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and
- (c) The remedy for non-performance is enforceable by law.

**Recognition Exemption: Leases for which the Underlying Asset is of Low Value (see paragraphs 6–9)**

- AG4. Except as specified in paragraph AG8, this Standard permits a lessee or a lessor to apply paragraph 7 to account for leases for which the underlying asset is of low value. A lessee or a lessor shall assess the value of an underlying asset based on the value of the asset when it is new, regardless of the age of the asset being leased.
- AG5. The assessment of whether an underlying asset is of low value is performed on an absolute basis. Leases of low-value assets qualify for the accounting treatment in paragraph 7 regardless of whether those leases are material to the lessee or to the lessor. The assessment is not affected by the size, nature or circumstances of the lessee or the lessor. Accordingly, different lessees or different lessors are expected to reach the same conclusions about whether a particular underlying asset is of low value.
- AG6. For a lessee, an underlying asset can be of low value only if:
- (a) The lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and
  - (b) The underlying asset is not highly dependent on, or highly interrelated with, other assets.
- AG7. A lease of an underlying asset does not qualify as a lease of a low-value asset if the nature of the asset is such that, when new, the asset is typically not of low value. For example, leases of cars would not qualify as leases of low-value assets because a new car would typically not be of low value.
- AG8. If a lessee subleases an asset, or expects to sublease an asset, the head lease does not qualify as a lease of a low-value asset.
- AG9. Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones.

**Identifying a Lease (see paragraphs 10–12)**

- AG10. To assess whether a contract conveys the right to control the use of an identified asset (see paragraphs AG14–AG21) for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:
- (a) The right to obtain substantially all of the economic benefits from use of the identified asset (as described in paragraphs AG22–AG24); and
  - (b) The right to direct the use of the identified asset (as described in paragraphs AG25–AG31).
- AG11. If the customer has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.
- AG12. A contract to receive goods or services may be entered into by a joint arrangement, or on behalf of a joint arrangement, as defined in ~~IFRS 11~~ IPSAS 37, Joint Arrangements. In this case, the joint arrangement is considered to be the customer in the contract. Accordingly, in assessing whether such a contract contains a lease, an entity shall assess whether the joint arrangement has the right to control the use of an identified asset throughout the period of use.

AG13. An entity shall assess whether a contract contains a lease for each potential separate lease component. Refer to paragraph AG33 for guidance on separate lease components.

*Identified Asset*

AG14. An asset is typically identified by being explicitly specified in a contract. However, an asset can also be identified by being implicitly specified at the time that the asset is made available for use by the customer.

*Substantive Substitution Rights*

AG15. Even if an asset is specified, a customer does not have the right to use an identified asset if the supplier has the substantive right to substitute the asset throughout the period of use. A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

- (a) The supplier has the practical ability to substitute alternative assets throughout the period of use (for example, the customer cannot prevent the supplier from substituting the asset and alternative assets are readily available to the supplier or could be sourced by the supplier within a reasonable period of time); and
- (b) The supplier would benefit economically from the exercise of its right to substitute the asset (i.e., the economic benefits associated with substituting the asset are expected to exceed the costs associated with substituting the asset).

AG16. If the supplier has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the supplier's substitution right is not substantive because the supplier does not have the practical ability to substitute alternative assets throughout the period of use.

AG17. An entity's evaluation of whether a supplier's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception of the contract, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include:

- (a) An agreement by a future customer to pay an above market rate for use of the asset;
- (b) The introduction of new technology that is not substantially developed at inception of the contract;
- (c) A substantial difference between the customer's use of the asset, or the performance of the asset, and the use or performance considered likely at inception of the contract; and
- (d) A substantial difference between the market price of the asset during the period of use, and the market price considered likely at inception of the contract.

AG18. If the asset is located at the customer's premises or elsewhere, the costs associated with substitution are generally higher than when located at the supplier's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset.

- AG19. The supplier's right or obligation to substitute the asset for repairs and maintenance, if the asset is not operating properly or if a technical upgrade becomes available does not preclude the customer from having the right to use an identified asset.
- AG20. If the customer cannot readily determine whether the supplier has a substantive substitution right, the customer shall presume that any substitution right is not substantive.

#### Portions of Assets

- AG21. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the customer with the right to obtain substantially all of the economic benefits from use of the asset.

#### *Right to Obtain Economic Benefits from Use*

- AG22. To control the use of an identified asset, a customer is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A customer can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.
- AG23. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a customer's right to use the asset (see paragraph AG31). For example:
- (a) If a contract limits the use of a motor vehicle to only one particular territory during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle within that territory, and not beyond.
  - (b) If a contract specifies that a customer can drive a motor vehicle only up to a particular number of miles during the period of use, an entity shall consider only the economic benefits from use of the motor vehicle for the permitted mileage, and not beyond.
- AG24. If a contract requires a customer to pay the supplier or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the customer obtains from use of the asset. For example, if the customer is required to pay the supplier a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the customer from having the right to obtain substantially all of the economic benefits from use of the retail space. This is because the cash flows arising from those sales are considered to be economic benefits that the customer obtains from use of the retail space, a portion of which it then pays to the supplier as consideration for the right to use that space.

*Right to Direct the Use*

AG25. A customer has the right to direct the use of an identified asset throughout the period of use only if either:

- (a) The customer has the right to direct how and for what purpose the asset is used throughout the period of use (as described in paragraphs AG26–AG31); or
- (b) The relevant decisions about how and for what purpose the asset is used are predetermined and:
  - (i) The customer has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use, without the supplier having the right to change those operating instructions; or
  - (ii) The customer designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

*How and for What Purpose the Asset is Used*

AG26. A customer has the right to direct how and for what purpose the asset is used if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout the period of use. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose the asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

AG27. Examples of decision-making rights that, depending on the circumstances, grant the right to change how and for what purpose the asset is used, within the defined scope of the customer's right of use, include:

- (a) Rights to change the type of output that is produced by the asset (for example, to decide whether to use a shipping container to transport goods or for storage, or to decide upon the mix of products sold from retail space);
- (b) Rights to change when the output is produced (for example, to decide when an item of machinery or a power plant will be used);
- (c) Rights to change where the output is produced (for example, to decide upon the destination of a truck or a ship, or to decide where an item of equipment is used); and
- (d) Rights to change whether the output is produced, and the quantity of that output (for example, to decide whether to produce energy from a power plant and how much energy to produce from that power plant).

AG28. Examples of decision-making rights that do not grant the right to change how and for what purpose the asset is used include rights that are limited to operating or maintaining the asset. Such rights can be held by the customer or the supplier. Although rights such as those to operate or maintain an asset are often essential to the efficient use of an asset, they are not rights to direct how and for

what purpose the asset is used and are often dependent on the decisions about how and for what purpose the asset is used. However, rights to operate an asset may grant the customer the right to direct the use of the asset if the relevant decisions about how and for what purpose the asset is used are predetermined (see paragraph AG25(b)(ii)).

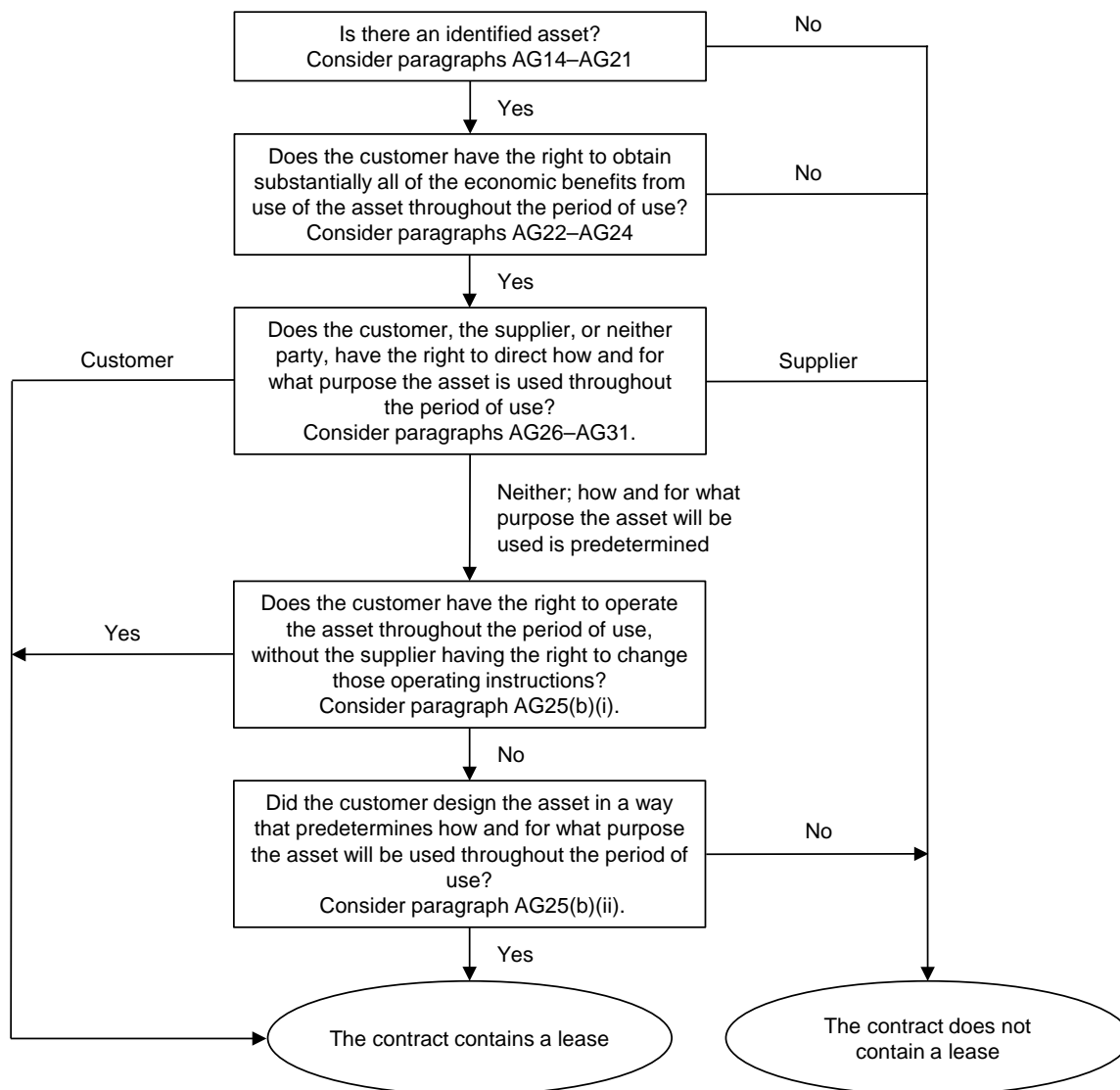
#### Decisions Determined during and before the Period of Use

- AG29. The relevant decisions about how and for what purpose the asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.
- AG30. In assessing whether a customer has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use, unless the customer designed the asset (or specific aspects of the asset) as described in paragraph AG25(b)(ii). Consequently, unless the conditions in paragraph AG25(b)(ii) exist, an entity shall not consider decisions that are predetermined before the period of use. For example, if a customer is able only to specify the output of an asset before the period of use, the customer does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a customer the same rights as any customer that purchases goods or services.

#### Protective Rights

- AG31. A contract may include terms and conditions designed to protect the supplier's interest in the asset or other assets, to protect its personnel, or to ensure the supplier's compliance with laws or regulations. These are examples of protective rights. For example, a contract may (i) specify the maximum amount of use of an asset or limit where or when the customer can use the asset, (ii) require a customer to follow particular operating practices, or (iii) require a customer to inform the supplier of changes in how an asset will be used. Protective rights typically define the scope of the customer's right of use but do not, in isolation, prevent the customer from having the right to direct the use of an asset.
- AG32. The following flowchart may assist entities in making the assessment of whether a contract is, or contains, a lease.

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**Separating Components of a Contract (see paragraphs 13–18)**

AG33. 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.

AG34. 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 (see paragraphs 19–22)**

AG35. 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.

AG36. 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.

AG37. The lease term begins at the commencement date and includes any rent-free periods provided to the lessee by the lessor.

AG38. 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:
  - (i) The amount of payments for the lease in any optional period;



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- (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.
- AG39. 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 AG48, 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.
- AG40. 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.
- AG41. 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.
- AG42. Paragraph 21 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 an business unit operation within which the right-of-use asset is employed).

AG43. A budget funding or cancellation clause (a clause that allows public sector lessees to cancel a lease agreement, typically on an annual basis, if the government does not appropriate funds for the lease payments) should be considered in determining the lease term only when it is reasonably certain that the clause will be exercised (i.e., funds will not be appropriated).

### **Concessionary Leases**

AG44. Concessionary leases are granted to or received by an entity at below market terms. Examples of concessionary leases include leases to international organizations or to other public sector entities with public policy objectives.

AG45. As concessionary leases are granted or received at below market terms, the transaction price on initial recognition of the lease will not be its fair value. At initial recognition, an entity therefore analyzes the substance of the lease granted or received into its component parts, and accounts for those components using the principles in paragraphs AG46 and AG47 below.

AG46. An entity firstly assesses whether the substance of the concessionary lease is in fact a financing transaction or a grant or a combination thereof, by applying the principles in the Standard and paragraphs 42-58 of IPSAS 23. If an entity has determined that, in substance, the concessionary lease is a grant (for example, leases for zero or nominal consideration), it accounts the concessionary lease as follows:

- (a) Where the concessionary lease (grant) is received by an entity, it is accounted in accordance with IPSAS 23.
- (b) Where the concessionary lease (grant) is granted by an entity, it is accounted according to the relevant international or national accounting standard.

AG47. If an entity has determined that the transaction is a combination of a financing transaction and a grant, any difference between the fair value of the lease and the transaction price (the total of lease payments) is treated as follows:

- (a) Where the concessionary lease is received by an entity, the difference is accounted in accordance with IPSAS 23.

- (b) Where the concessionary lease is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the lease is a transaction with owners, in their capacity as owners. For example, where a controlling entity provides a concessionary lease to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.

Illustrative examples are provided in paragraphs IG55 of IPSAS 23 as well as paragraph IE6 accompanying this Standard.

### **In-substance Fixed Lease Payments (see paragraphs 31(a), 40(c) 60(a))**

AG48. Lease payments include any in-substance fixed lease payments. In-substance fixed lease payments are payments that may, in form, contain variability but that, in substance, are unavoidable. In-substance fixed lease payments exist, for example, if:

- (a) Payments are structured as variable lease payments, but there is no genuine variability in those payments. Those payments contain variable clauses that do not have real economic substance. Examples of those types of payments include:
  - (i) Payments that must be made only if an asset is proven to be capable of operating during the lease, or only if an event occurs that has no genuine possibility of not occurring; or
  - (ii) Payments that are initially structured as variable lease payments linked to the use of the underlying asset but for which the variability will be resolved at some point after the commencement date so that the payments become fixed for the remainder of the lease term. Those payments become in-substance fixed payments when the variability is resolved.
- (b) There is more than one set of payments that a lessee could make, but only one of those sets of payments is realistic. In this case, an entity shall consider the realistic set of payments to be lease payments.
- (c) There is more than one realistic set of payments that a lessee could make, but it must make at least one of those sets of payments. In this case, an entity shall consider the set of payments that aggregates to the lowest amount (on a discounted basis) to be lease payments.

### **Lessee Involvement with the Underlying Asset before the Commencement Date**

#### *Costs of the Lessee Relating to the Construction or Design of the Underlying Asset*

- AG49. An entity may negotiate a lease before the underlying asset is available for use by the lessee. For some leases, the underlying asset may need to be constructed or redesigned for use by the lessee. Depending on the terms and conditions of the contract, a lessee may be required to make payments relating to the construction or design of the asset.
- AG50. If a lessee incurs costs relating to the construction or design of an underlying asset, the lessee shall account for those costs applying other applicable Standards, such as ~~IAS 46~~ IPSAS 17. Costs relating to the construction or design of an underlying asset do not include payments made by the

lessee for the right to use the underlying asset. Payments for the right to use an underlying asset are payments for a lease, regardless of the timing of those payments.

*Legal Title to the Underlying Asset*

- AG51. A lessee may obtain legal title to an underlying asset before that legal title is transferred to the lessor and the asset is leased to the lessee. Obtaining legal title does not in itself determine how to account for the transaction.
- AG52. If the lessee controls (or obtains control of) the underlying asset before that asset is transferred to the lessor, the transaction is a sale and leaseback transaction that is accounted for applying paragraphs 87–92.
- AG53. However, if the lessee does not obtain control of the underlying asset before the asset is transferred to the lessor, the transaction is not a sale and leaseback transaction. ~~For example, this may be the case if a manufacturer, a lessor and a lessee negotiate a transaction for the purchase of an asset from the manufacturer by the lessor, which is in turn leased to the lessee. The lessee may obtain legal title to the underlying asset before legal title transfers to the lessor. In this case, if the lessee obtains legal title to the underlying asset but does not obtain control of the asset before it is transferred to the lessor, the transaction is not accounted for as a sale and leaseback transaction, but as a lease.~~

**Lessee disclosures (see paragraph XX)**

- AG54. [To be discussed at the September 2017 meeting]
- AG55. [To be discussed at the September 2017 meeting]
- AG56. [To be discussed at the September 2017 meeting]
- AG57. [To be discussed at the September 2017 meeting]
- AG58. [To be discussed at the September 2017 meeting]

**~~Lessor lease classification (paragraphs 61–66)~~**

- ~~B53—The classification of leases for lessors in this Standard is based on the extent to which the lease transfers the risks and rewards incidental to ownership of an underlying asset. Risks include the possibilities of losses from idle capacity or technological obsolescence and of variations in return because of changing economic conditions. Rewards may be represented by the expectation of profitable operation over the underlying asset's economic life and of gain from appreciation in value or realisation of a residual value.~~
- ~~B54—A lease contract may include terms and conditions to adjust the lease payments for particular changes that occur between the inception date and the commencement date (such as a change in the lessor's cost of the underlying asset or a change in the lessor's cost of financing the lease). In that case, for the purposes of classifying the lease, the effect of any such changes shall be deemed to have taken place at the inception date.~~
- ~~B55—When a lease includes both land and buildings elements, a lessor shall assess the classification of each element as a finance lease or an operating lease separately applying paragraphs 62–66 and~~

- ~~B53–B54. In determining whether the land element is an operating lease or a finance lease, an important consideration is that land normally has an indefinite economic life.~~
- ~~B56—Whenever necessary in order to classify and account for a lease of land and buildings, a lessor shall allocate lease payments (including any lump-sum upfront payments) between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception date. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.~~
- ~~B57—For a lease of land and buildings in which the amount for the land element is immaterial to the lease, a lessor may treat the land and buildings as a single unit for the purpose of lease classification and classify it as a finance lease or an operating lease applying paragraphs 62–66 and B53–B54. In such a case, a lessor shall regard the economic life of the buildings as the economic life of the entire underlying asset.~~

### **Sublease classification**

- ~~B58—In classifying a sublease, an intermediate lessor shall classify the sublease as a finance lease or an operating lease as follows:~~
- ~~(a)—if the head lease is a short-term lease that the entity, as a lessee, has accounted for applying paragraph 6, the sublease shall be classified as an operating lease.~~
  - ~~(b)—otherwise, the sublease shall be classified by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying asset (for example, the item of property, plant or equipment that is the subject of the lease).~~

### **Lessor**

#### *Recognition and Measurement of Unearned Revenue (see paragraphs 72–73)*

- AG59. When the lessor fulfills its obligation to make the underlying asset available for use by the lessee, the lessee is granted the right to earn revenue over the lease term because it controls the right-of-use asset. Likewise, the lessor earns the benefit associated with the lease receivable in exchange for the right to use the underlying asset granted to the lessee over the lease term. Accordingly, the revenue is not recognized immediately. Instead, unearned revenue is recognized for the revenue that is not yet earned in accordance with paragraph 56. Revenue is recognized and the unearned revenue reduced in accordance with paragraph 72 based on the economic substance of the lease contract, usually as access to the underlying asset is provided to the lessee over the lease term.

### *Sublease*

- AG60. A sublease involves three parties: the head lessor, the intermediate lessor (who is the lessee in the head lease), and a third party (the new lessee). The head lessor should continue to apply the lessor accounting requirements in this Standard. The intermediate lessor should account for the head lease and the sublease as two separate transactions, as a lessee and as a lessor, respectively. Those separate transactions should not be offset against one another. The new lessee should apply the lessee accounting requirements in this Standard.

- AG61. The intermediate lessor should disclose the sublease arrangements separately from its lessee transactions related to the head lease.

## **Amendments to Other IPSASs**

### **Amendments to IPSAS 2, *Cash Flow Statements***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 4, *The Effects of Changes in Foreign Exchange Rates***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 5, *Borrowing Costs***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 9, *Revenue from Exchange Transactions***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 12, *Inventories***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 16, *Investment Property***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 17, *Property, Plant, and Equipment***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 18, *Segment Reporting***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 27, *Agriculture***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 28, *Financial Instruments: Presentation***

[To be discussed at the September 2017 meeting]

### **Amendments to IPSAS 29, *Financial Instruments: Recognition and Measurement***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS 30, *Financial Instruments: Disclosures***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS 31, *Intangible Assets***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS 32, *Service Concession Arrangements: Grantor***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS 33, *First-Time Adoption of Accrual Basis IPSASs***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS 40, *Public Sector Combinations***

[To be discussed at the September 2017 meeting]

**Amendments to IPSAS, *Financial Reporting Under the Cash Basis of Accounting***

[To be discussed at the September 2017 meeting]



## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, [draft] IPSAS [X] (ED X).*

### Objective (see paragraphs 1–2)

- BC1. IPSAS 13 (2001), *Leases*, was drawn primarily from International Accounting Standard (IAS) 17 (Revised 2003), *Leases*, issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaces IAS 17, International Financial Reporting Interpretation Committee (IFRIC) 4, *Determining whether an Arrangement contains a Lease*, Standard Interpretations Committee (SIC) 15, *Operating Leases—Incentives*, and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.
- BC2. In order to maintain convergence with the underlying IFRS, the IPSASB approved a project to develop revised requirements for lease accounting covering both lessees and lessors. The IPSASB believes this [draft] Standard will promote consistency and comparability in how leases are reported by public sector entities.

### Scope (see paragraphs 3–4)

- BC3. The IPSASB considered the scope of IFRS 16 and did not identify a public sector specific difference that would warrant a different scope this [draft] Standard, except for the scope exclusion of leases for zero or nominal consideration. The IPSASB is of the view that leases for zero or nominal consideration are in substance a grant in kind and, therefore, outside of the scope of this [draft] Standard.
- BC4. This [draft] Standard amended IPSAS 23, *Revenue from Non-Exchange Transactions* to provide guidance to account for concessionary leases from the recipient side. That guidance is applicable to the subsidized component of leases for zero or nominal consideration from the lessee side.
- BC5. The IPSASB has underway a project on Revenue and Non-Exchange Expenses. Until an IPSAS on Non-Exchange Expenses is published, preparers can apply the relevant international or national accounting standard to the subsidized component in lessor's accounts.

### Definitions (see paragraph 5 and AG3)

#### *Definition of a Lease*

#### Concessionary Leases

- BC6. Concessionary leases are granted to or received by an entity at below market terms. The IPSASB considered the economic substance of several types of concessionary leases. The IPSASB is of the view that leases with consideration above nominal amount still meet the IFRS 16 definition of a lease. As a consequence of this IPSASB's view and the IPSASB's decision identified in paragraph BC3, the IPSASB decided to retain in this [draft] Standard the wording "in exchange for consideration" in IFRS 16 definition of a lease.

**Contractual Arrangements**

- BC7. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a “government order.” To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.
- BC8. Consideration was given as to whether the term “binding arrangement” should be used to describe the arrangements highlighted in paragraph BC7. The term “binding arrangement” is defined as contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. For example, an arrangement between two government departments that do not have the power to contract. The IPSASB concluded that the term “binding arrangements,” as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph BC7 and therefore concluded that it should not be used in this [draft] IPSAS.

*IFRS 16 Definitions on Lessor Accounting*

- BC9. The IPSASB decided not to include the IFRS 16 requirements on lessor accounting (see paragraphs BC29–BC33) in this [draft] Standard. Therefore, this [draft] Standard does not include the definitions related to IFRS 16 lessor accounting and, consequently, amended IFRS 16 definitions of initial direct costs and interest rate implicit in the lease.

**Recognition Exemptions (see paragraphs 6–9)***Lessee Accounting*

- BC10. The IPSASB considered the recognition exemptions in IFRS 16. The IPSASB did not identify a public sector specific reason that would warrant different recognition exemptions in this [draft] Standard.
- BC11. The IPSASB also considered whether the permissive recognition exemptions in IFRS 16 should be a requirement or an option in this [draft] IPSAS. 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 the comparability between public sector entities and provide increased cost relief to them, with a low probability of a negative impact on the reliability and accuracy of financial statements. However, on the other hand, the IPSASB noted that requiring recognition exemptions for short-term leases may create a new arbitrage point, where entities could design their lease contracts to achieve desired accounting outcomes.
- BC12. 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 faithful representation of leasing transactions in terms of their own statements of financial position.
- BC13. The IPSASB noted that IFRS 16 does not set a specific dollar amount for a lease of a low value asset. Instead, the IASB included in paragraph BC100 of the Basis for 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 dollar amount, or not make any reference to a threshold in the Basis for Conclusions of this [draft] Standard.

- BC14. The IPSASB acknowledged that, for many public sector entities that are services-based, a figure of US\$5,000 might represent the value of most of their assets. The IPSASB concluded that public sector entities, if they decide to apply the exemption, should use a threshold for determining leases of low-value assets, considering the materiality of leasing transactions in relation to their financial statements, and that the IPSASB would not provide guidance on a specific monetary amount. In assessing materiality, preparers consider if the omission of information could influence users' assessments of accountability or their decision-making.

#### *Lessor Accounting*

- BC15. The IPSASB considered the IFRS 16 recognition exemptions for lessee accounting in the context of the right-of-use model for lessor accounting included in this [draft] Standard. The IPSASB concluded that the IPSASB's reasons to adopt recognition exemptions in lessee accounting are also applicable to lessor accounting. Therefore, this [draft] Standard proposes the same recognition exemptions for lessees and lessors, and the reasons presented in the above paragraphs BC10–BC14 are also applicable to lessors.

#### **Identifying a Lease (see paragraphs 10–12)**

- BC16. The IPSASB considered the IFRS 16 requirements to identify a lease, including separating components of a contract. The IPSASB did not identify a public sector specific reason that would warrant different requirements in this [draft] Standard.
- BC17. The IPSASB agreed that the guidance in paragraphs AG10–AG32 of this [draft] Standard complements the flowchart in the Implementation Guidance section of IPSAS 32, *Service Concession Arrangements: Grantor* in distinguishing a lease from a service concession arrangement and helps public sector entities apply this [draft] Standard.

#### **Lease Term (see paragraphs 19–22 and AG43)**

- BC18. The IPSASB considered the requirements of lease term in IFRS 16. The IPSASB did not identify a public sector specific reason that would warrant different requirements in this [draft] Standard.
- BC19. The IPSASB acknowledged that many times in the public sector lease contracts have budget funding or cancellation clauses. These clauses allow public sector lessees to terminate a lease agreement, typically on an annual basis, if the government does not appropriate funds for the lease payments.
- BC20. The IPSASB concluded that these types of clauses should be assessed in the same way as other termination options because there is not a public sector specific reason that warrant a departure from the principles in IFRS 16. Therefore, the IPSASB decided to include in the Application Guidance section of this [draft] Standard specific guidance on these types of clauses by applying the same principles as for other termination options.

## **Lessee Accounting (see paragraphs 23–XX)**

### *Recognition*

- BC21. The IPSASB considered the recognition requirements of the right-of-use model in IFRS 16 for lessee accounting and did not identify a public sector specific reason that would warrant different recognition requirements in this [draft] Standard.
- BC22. The IPSASB is of the view that lessee accounting recognition requirements of the right-of-use model better reflects the economics of a lease than the risks and rewards incidental to ownership model because:
- (a) The lessee no longer recognizes an underlying asset that it does not control, as in requirements in IPSAS 13 for finance lease;
  - (b) The lessee always recognizes an asset (the right-of-use asset), unlike in IPSAS 13 for operating leases;
  - (c) The lessee always recognizes the obligations resulting from the lease contract as liabilities, unlike in IPSAS 13 for operating leases; and
  - (d) The right-of-use model prevents arbitrage, gaming and information asymmetry, and improves comparability between public sector entities that lease assets and public sector entities that purchase assets.

### *Measurement*

#### **Right-of-Use Asset and Lease Receivable**

- BC23. The IPSASB considered the measurement requirements of the right-of-use asset and the lease liability in IFRS 16 for lessee accounting. IFRS 16 requires the right-of-use asset and the lease liability to be initially measured at cost because IFRS 16 only deals with leases that are exchange transactions. IFRS 16 does not provide guidance on how to account for leases that are non-exchange transactions.
- BC24. As quite often in the public sector there are leases that are not exchange transactions (for example, concessionary leases), the IPSASB concluded that a cost model is not appropriate for these type of leases because applying IFRS 16 measurement requirements to concessionary leases will lead to an understatement of the right-of-use asset and a failure to recognize the subsidy from the lessor to the lessee in the financial statements of both the lessee and the lessor.
- BC25. Therefore, the IPSASB decided to require in this [draft] Standard to initially measure at cost the right-of-use asset and the lease receivable of leases that are exchange transactions and at fair value the right-of-use asset and the lease receivable of leases that are non-exchange transactions.
- BC26. This [draft] Standard also requires the lease receivable to be subsequently measured at amortized cost. This approach is consistent with the principles in:
- (a) IPSAS 29, *Financial Instruments: Recognition and Measurement* because the lease receivable is held within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

- (b) Exposure Draft 62, *Financial Instruments* because of the reason in the above sub-paragraph (a) and because the contractual terms of the lease receivable give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

#### *Presentation*

BC27. [to be added at the September 2017 meeting]

#### *Disclosures*

BC28. [to be added at the September 2017 meeting]

### **Lessor Accounting**

#### *IFRS 16 Risks and Rewards Incidental to Ownership Model*

- BC29. The IPSASB noted that IFRS 16 retained the risks and rewards incidental to ownership dual model that previously existed in IAS 17, *Leases*. The IPSASB also noted that with the introduction of the single right-of-use model in lessee accounting and the retention of the dual model in lessor accounting, there is a lack of symmetry in analyzing the economics of a lease from a conceptual point of view. This lack of symmetry in lease accounting leads to the following accounting situations:
- (a) The underlying asset is not recognized by the lessee nor by the lessor if the lessor classifies the lease as finance lease; and
  - (b) The lease receivable is not recognized by the lessor if the lessor classifies the lease as operating lease.
- BC30. The IPSASB concluded that the situations identified in BC29(a) and BC29(b) would lead to assets not being recognized in the public sector when both lessee and lessor are public sector entities in the same lease contract.
- BC31. The IPSASB is of the view that a lease conveys the right to use an underlying asset for a period of time and does not transfer control of the underlying asset to an entity—such transactions are sales or purchases within the scope of other Standards (for example, IPSAS 9, *Revenue from Exchange Transactions* or IPSAS 17, *Property, Plant, and Equipment*).
- BC32. Therefore, the IPSASB concluded that the retention of IFRS 16 lessor accounting model is not appropriate for public sector financial reporting for the following reasons:
- (a) It is inconsistent with *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) because:
    - (i) The *Conceptual Framework* follows a control-based approach to recognize and derecognize assets; and
    - (ii) The underlying asset and the lease receivable meet the definition of an asset;
  - (b) Impairs the public sector financial reporting objectives of accountability and decision-making because by not recognizing in the statement of financial position the underlying asset that it controls:

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- (i) The public sector entity 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;”<sup>2</sup> and
  - (ii) 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 that 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;”<sup>3</sup>
  - (c) It is inconsistent with IPSAS 32, *Service Concession Arrangements: Grantor* because:
    - (i) IPSAS 32 is the mirror accounting of IFRIC 12, *Service Concession Arrangements*; and
    - (ii) In IPSAS 32, the grantor never derecognizes the underlying asset in both the liability model and the grant of a right to the operator model;
  - (d) It is inconsistent with IPSAS 29, *Financial Instruments: Recognition and Measurement* because:
    - (i) Leases are in substance financing transactions; and
    - (ii) The lease receivable meets the definition of a financial asset; and
  - (e) It is inconsistent with lessee accounting as explained in BC29.
- BC33. As a consequence, the IPSASB decided to develop a single right-of-use model for lessor accounting specifically designed for public sector financial reporting.

*Right-of-Use Model for Lessors in Public Sector Financial Reporting*

- BC34. The right-of-use model for lease accounting is based on the foundational principle that leases are financings of the right to use an underlying asset. Based on this principle, the IPSASB considered two mutually exclusive approaches to the right-of-use model for lessor accounting, as follows:
- (a) Whether the physical asset should continue to be recognized in its entirety in the lessor’s accounts (Approach 1), or whether portions of individually controlled rights over the physical asset should be derecognized (Approach 2); and
  - (b) Whether the lessor should recognize the credit entry over the lease term in the statement of financial performance (Approach 1), or immediately (Approach 2).
- BC35. The IPSASB concluded that Approach 1 provides the most consistent accounting treatment with IPSASB’s literature, as follows:
- (a) It is consistent with the *Conceptual Framework* derecognition criteria where it refers to the removal of an item, not portions (rights) of an item;

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<sup>2</sup> Paragraph 2.8 of the *Conceptual Framework*

<sup>3</sup> Paragraph 2.9 of the *Conceptual Framework*

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- (b) It does not conflict with the principles in IPSAS 16, *Investment Property*, IPSAS 17 and IPSAS 32 that the underlying assets are recognized and derecognized in their entirety because assets are not recognized and derecognized as portions (“slices”) of individually controlled rights;
- (c) It is consistent with a control-based approach to the recognition of assets because a lease does not transfer control of the underlying asset (see paragraph BC31); and
- (d) It is consistent with IPSAS 32, where revenue is recognized over time.

BC36. The IPSASB also concluded that Approach 1:

- (a) Is consistent with lessee accounting at type of asset level because the lessee controls the right-of-use asset, and the lessor controls the physical asset; and
- (b) Best meets the public interest as it provides the most understandable approach to lessor accounting because the unique economic substance of a physical asset will always be reflected in the lessor’s financial statements.

BC37. In contrast, Approach 2 is not consistent with IPSASB’s literature because:

- (a) It conflicts with the principles in IPSAS 16, IPSAS 17, and IPSAS 32 that the underlying asset is recognized/derecognized in its entirety;
- (b) It is inconsistent with a control-based approach to asset recognition and derecognition; and
- (c) It does not recognize revenue in a manner consistent with IPSAS 32.

BC38. Therefore, the IPSASB decided to adopt Approach 1 in this [draft] Standard.

*Recognition of a Lease Receivable*

BC39. The lessor has fulfilled its obligation to transfer the right to use that asset to the lessee when it makes the underlying asset available for use by the lessee. At this moment, the lessee controls the right of use. Therefore, the lessor has an unconditional right to receive lease payments (the lease receivable).

BC40. The IPSASB concluded that the lease receivable meets the definition of an asset because:

- (a) It is a resource—i.e., it is an item with service potential or the ability to generate economic benefits (typically cash from the lessee to the lessor);
- (b) It is presently controlled by the entity—for example, it can decide to sell or securitize the lease receivable; and
- (c) It arises from a past event—the commitment to the lease contract and the underlying asset being made available for use by the lessee.

*Measurement of a Lease Receivable*

BC41. The IPSASB considered the measurement requirements of lessee’s lease liability in this [draft] Standard for lessor’s lease receivable. The IPSASB decided to adopt the same measurement requirements of lessor’s lease receivable in order to mirror the lessee’s lease liability, to the extent possible.

BC42. Additionally, the IPSASB also decided to require derecognition and impairment requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement* to the lease receivable in order to ensure consistent treatment with other financial assets.

*Recognition of Unearned Revenue*

BC43. [To be added after the June 2017 meeting]

*Measurement of Unearned Revenue*

BC44. [To be added after the June 2017 meeting]

*Measurement of the Underlying Asset*

BC45. The IPSASB considered the measurement bases of the underlying asset that are used in IPSAS 16, 17 and 31, *Intangible Assets*.

BC46. In the historical cost basis, the IPSASB considered whether continuing to recognize the underlying asset at cost and recognizing the lease receivable would imply double-counting and, therefore, inflating the lessor's total assets. The IPSASB concluded that recognizing both a lease receivable and the underlying asset does not inflate lessor's statement of financial position because:

- (a) A lease does not negate the historical cost of the underlying asset incurred by the lessor; and
- (b) The lease receivable and the underlying asset have different economic natures—The value of the underlying asset is the historical cost incurred to purchase it, and the lease receivable is the present value of future lease payments that the lessor will receive for granting the right to use the underlying asset. The two assets result from two different transactions and provide different information, as follows:
  - (i) 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.
  - (ii) The historical cost of the underlying asset can provide 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.
  - (iii) The historical cost of the underlying asset provides information on the resources available to provide services in future periods even though they are being provided by a third party—the lessee. This is relevant to an assessment of operational capacity.

BC47. The IPSASB noted that, as the historical cost requires the underlying asset to be tested for impairment, the cost of the underlying asset will be reduced if the lease implies any loss in the future economic benefits or service potential of the underlying asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

BC48. In the fair value basis, [To be added at the September 2017 meeting]



*Presentation*

BC49. [To be added at the September 2017 meeting]

*Disclosures*

BC50. [To be added at the September 2017 meeting]

**Sale and Leaseback Transactions**

- BC51. The IPSASB considered the requirement in IFRS 16 that determining whether the transfer of an asset is accounted for as a sale of that asset is dependent on whether a performance obligation is satisfied in accordance with IFRS 15, *Revenue from Contracts with Customers*.
- BC52. 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, rather than the control-based approach in IFRS 15.
- BC53. The IPSASB considers that a new IPSAS on Leases should have a similar requirement to 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 15 should replace IPSAS 9 and IPSAS 11, *Construction Contracts*.

*Leaseback at Below Market Terms*

- BC54. The IPSASB considered on whether leasebacks at below market terms should apply the requirements in IFRS 16.101(a) or the IPSAS 23 requirements to account for the subsidy component.
- BC55. The IPSASB noted that in a leaseback at below market terms it is almost impossible to know whether the price of the sale was not influenced by the price of the leaseback, or vice-versa, because the leaseback is made right after the sale and with the same party.
- BC56. The IPSASB concluded to apply the IFRS 16 requirements in this [draft] IPSAS for the following reasons:
- (a) The IPSASB did not identify a public sector specific reason to warrant departure from IFRS 16; and
  - (b) Leasebacks at below market terms and concessionary leases are in substance different transactions because they have different starting points—a leaseback at below market terms is linked to a sale in the first place with the same party, and a concessionary lease is not linked to a sale in the first place with the same party.

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## Illustrative Examples

*These examples accompany, but are not part of, [draft] IPSAS [X] (ED [X])*

- IE1. These examples portray hypothetical situations illustrating how an entity might apply some of the requirements in ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to particular aspects of a lease (or other contracts) on the basis of the limited facts presented. The analysis in each example is not intended to represent the only manner in which the requirements could be applied, nor are the examples intended to apply only to the specific industry illustrated. Although some aspects of the examples may be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]).

### Identifying a Lease (see paragraphs 10–12 and AG10–AG31)

- IE2. The following examples illustrate how an entity determines whether a contract is, or contains, a lease.

#### *Example 1—Rail Cars*

*Example 1A: a contract between Customer and a freight carrier (Supplier) provides Customer with the use of 10 rail cars of a particular type for five years. The contract specifies the rail cars; the cars are owned by Supplier. Customer determines when, where and which goods are to be transported using the cars. When the cars are not in use, they are kept at Customer's premises. Customer can use the cars for another purpose (for example, storage) if it so chooses. However, the contract specifies that Customer cannot transport particular types of cargo (for example, explosives). If a particular car needs to be serviced or repaired, Supplier is required to substitute a car of the same type. Otherwise, and other than on default by Customer, Supplier cannot retrieve the cars during the five-year period.*

*The contract also requires Supplier to provide an engine and a driver when requested by Customer. Supplier keeps the engines at its premises and provides instructions to the driver detailing Customer's requests to transport goods. Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers (i.e., if other customers require the transportation of goods to destinations close to the destination requested by Customer and within a similar timeframe, Supplier can choose to attach up to 100 rail cars to the engine).*

The contract contains leases of rail cars. Customer has the right to use 10 rail cars for five years.

There are 10 identified cars. The cars are explicitly specified in the contract. Once delivered to Customer, the cars can be substituted only when they need to be serviced or repaired (see paragraph AG19). The engine used to transport the rail cars is not an identified asset because it is neither explicitly specified nor implicitly specified in the contract.

Customer has the right to control the use of the 10 rail cars throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the cars over the five-year period of use. Customer has exclusive use of the cars throughout the period of use, including when they are not being used to transport Customer's goods.

- (b) Customer has the right to direct the use of the cars because the conditions in paragraph AG25(a) exist. The contractual restrictions on the cargo that can be transported by the cars are protective rights of Supplier and define the scope of Customer's right to use the cars. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose the cars are used by being able to decide when and where the rail cars will be used and which goods are transported using the cars. Customer also determines whether and how the cars will be used when not being used to transport its goods (for example, whether and when they will be used for storage). Customer has the right to change these decisions during the five-year period of use.

Although having an engine and driver (controlled by Supplier) to transport the rail cars is essential to the efficient use of the cars, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the rail cars are used. Consequently, Supplier does not control the use of the cars during the period of use.

*Example 1B: the contract between Customer and Supplier requires Supplier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for a period of five years. The timetable and quantity of goods specified are equivalent to Customer having the use of 10 rail cars for five years. Supplier provides the rail cars, driver and engine as part of the contract. The contract states the nature and quantity of the goods to be transported (and the type of rail car to be used to transport the goods). Supplier has a large pool of similar cars that can be used to fulfil the requirements of the contract. Similarly, Supplier can choose to use any one of a number of engines to fulfil each of Customer's requests, and one engine could be used to transport not only Customer's goods, but also the goods of other customers. The cars and engines are stored at Supplier's premises when not being used to transport goods.*

The contract does not contain a lease of rail cars or of an engine.

The rail cars and the engines used to transport Customer's goods are not identified assets. Supplier has the substantive right to substitute the rail cars and engine because:

- (a) Supplier has the practical ability to substitute each car and the engine throughout the period of use (see paragraph AG15(a)). Alternative cars and engines are readily available to Supplier and Supplier can substitute each car and the engine without Customer's approval.
- (b) Supplier would benefit economically from substituting each car and the engine (see paragraph AG15(b)). There would be minimal, if any, cost associated with substituting each car or the engine because the cars and engines are stored at Supplier's premises and Supplier has a large pool of similar cars and engines. Supplier benefits from substituting each car or the engine in contracts of this nature because substitution allows Supplier to, for example, (i) use cars or an engine to fulfil a task for which the cars or engine are already positioned to perform (for example, a task at a rail yard close to the point of origin) or (ii) use cars or an engine that would otherwise be sitting idle because they are not being used by a customer.

Accordingly, Customer does not direct the use, nor have the right to obtain substantially all of the economic benefits from use, of an identified car or an engine. Supplier directs the use of the rail cars and engine by selecting which cars and engine are used for each particular delivery and

obtains substantially all of the economic benefits from use of the rail cars and engine. Supplier is only providing freight capacity.

#### *Example 2—Concession Space*

*A coffee company (Customer) enters into a contract with an airport operator (Supplier) to use a space in the airport to sell its goods for a three-year period. The contract states the amount of space and that the space may be located at any one of several boarding areas within the airport. Supplier has the right to change the location of the space allocated to Customer at any time during the period of use. There are minimal costs to Supplier associated with changing the space for the Customer: Customer uses a kiosk (that it owns) that can be moved easily to sell its goods. There are many areas in the airport that are available and that would meet the specifications for the space in the contract.*

The contract does not contain a lease.

Although the amount of space Customer uses is specified in the contract, there is no identified asset. Customer controls its owned kiosk. However, the contract is for space in the airport, and this space can change at the discretion of Supplier. Supplier has the substantive right to substitute the space Customer uses because:

- (a) Supplier has the practical ability to change the space used by Customer throughout the period of use (see paragraph AG15(a)). There are many areas in the airport that meet the specifications for the space in the contract, and Supplier has the right to change the location of the space to other space that meets the specifications at any time without Customer's approval.
- (b) Supplier would benefit economically from substituting the space (see paragraph AG15(b)). There would be minimal cost associated with changing the space used by Customer because the kiosk can be moved easily. Supplier benefits from substituting the space in the airport because substitution allows Supplier to make the most effective use of the space at boarding areas in the airport to meet changing circumstances.

#### *Example 3—Fibre-Optic Cable*

*Example 3A: Customer enters into a 15-year contract with a utilities company (Supplier) for the right to use three specified, physically distinct dark fibres within a larger cable connecting Hong Kong to Tokyo. Customer makes the decisions about the use of the fibres by connecting each end of the fibres to its electronic equipment (i.e., Customer 'lights' the fibres and decides what data, and how much data, those fibres will transport). If the fibres are damaged, Supplier is responsible for the repairs and maintenance. Supplier owns extra fibres, but can substitute those for Customer's fibres only for reasons of repairs, maintenance or malfunction (and is obliged to substitute the fibres in these cases).*

The contract contains a lease of dark fibres. Customer has the right to use the three dark fibres for 15 years.

There are three identified fibres. The fibres are explicitly specified in the contract and are physically distinct from other fibres within the cable. Supplier cannot substitute the fibres other than for reasons of repairs, maintenance or malfunction (see paragraph AG19).

Customer has the right to control the use of the fibres throughout the 15-year period of use because:

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- (a) Customer has the right to obtain substantially all of the economic benefits from use of the fibres over the 15-year period of use. Customer has exclusive use of the fibres throughout the period of use.
- (b) Customer has the right to direct the use of the fibres because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the fibres are used by deciding (i) when and whether to light the fibres and (ii) when and how much output the fibres will produce (i.e., what data, and how much data, those fibres will transport). Customer has the right to change these decisions during the 15-year period of use.

Although Supplier's decisions about repairing and maintaining the fibres are essential to their efficient use, those decisions do not give Supplier the right to direct how and for what purpose the fibres are used. Consequently, Supplier does not control the use of the fibres during the period of use.

*Example 3B: Customer enters into a 15-year contract with Supplier for the right to use a specified amount of capacity within a cable connecting Hong Kong to Tokyo. The specified amount is equivalent to Customer having the use of the full capacity of three fibre strands within the cable (the cable contains 15 fibres with similar capacities). Supplier makes decisions about the transmission of data (i.e., Supplier lights the fibres, makes decisions about which fibres are used to transmit Customer's traffic and makes decisions about the electronic equipment that Supplier owns and connects to the fibres).*

The contract does not contain a lease.

Supplier makes all decisions about the transmission of its customers' data, which requires the use of only a portion of the capacity of the cable for each customer. The capacity portion that will be provided to Customer is not physically distinct from the remaining capacity of the cable and does not represent substantially all of the capacity of the cable (see paragraph AG21). Consequently, Customer does not have the right to use an identified asset.

#### *Example 4—Retail Unit*

*Customer enters into a contract with a property owner (Supplier) to use Retail Unit A for a five-year period. Retail Unit A is part of a larger retail space with many retail units.*

*Customer is granted the right to use Retail Unit A. Supplier can require Customer to relocate to another retail unit. In that case, Supplier is required to provide Customer with a retail unit of similar quality and specifications to Retail Unit A and to pay for Customer's relocation costs. Supplier would benefit economically from relocating Customer only if a major new tenant were to decide to occupy a large amount of retail space at a rate sufficiently favourable to cover the costs of relocating Customer and other tenants in the retail space. However, although it is possible that those circumstances will arise, at inception of the contract, it is not likely that those circumstances will arise.*

*The contract requires Customer to use Retail Unit A to operate its well-known store brand to sell its goods during the hours that the larger retail space is open. Customer makes all of the decisions about the use of the retail unit during the period of use. For example, Customer decides on the mix*

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*of goods sold from the unit, the pricing of the goods sold and the quantities of inventory held. Customer also controls physical access to the unit throughout the five-year period of use.*

*The contract requires Customer to make fixed payments to Supplier, as well as variable payments that are a percentage of sales from Retail Unit A.*

*Supplier provides cleaning and security services, as well as advertising services, as part of the contract.*

The contract contains a lease of retail space. Customer has the right to use Retail Unit A for five years.

Retail Unit A is an identified asset. It is explicitly specified in the contract. Supplier has the practical ability to substitute the retail unit, but could benefit economically from substitution only in specific circumstances. Supplier's substitution right is not substantive because, at inception of the contract, those circumstances are not considered likely to arise (see paragraph AG17).

Customer has the right to control the use of Retail Unit A throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of Retail Unit A over the five-year period of use. Customer has exclusive use of Retail Unit A throughout the period of use. Although a portion of the cash flows derived from sales from Retail Unit A will flow from Customer to Supplier, this represents consideration that Customer pays Supplier for the right to use the retail unit. It does not prevent Customer from having the right to obtain substantially all of the economic benefits from use of Retail Unit A.
- (b) Customer has the right to direct the use of Retail Unit A because the conditions in paragraph AG25(a) exist. The contractual restrictions on the goods that can be sold from Retail Unit A, and when Retail Unit A is open, define the scope of Customer's right to use Retail Unit A. Within the scope of its right of use defined in the contract, Customer makes the relevant decisions about how and for what purpose Retail Unit A is used by being able to decide, for example, the mix of products that will be sold in the retail unit and the sale price for those products. Customer has the right to change these decisions during the five-year period of use.

Although cleaning, security, and advertising services are essential to the efficient use of Retail Unit A, Supplier's decisions in this regard do not give it the right to direct how and for what purpose Retail Unit A is used. Consequently, Supplier does not control the use of Retail Unit A during the period of use and Supplier's decisions do not affect Customer's control of the use of Retail Unit A.

#### *Example 5—Truck Rental*

*Customer enters into a contract with Supplier for the use of a truck for one week to transport cargo from New York to San Francisco. Supplier does not have substitution rights. Only cargo specified in the contract is permitted to be transported on this truck for the period of the contract. The contract specifies a maximum distance that the truck can be driven. Customer is able to choose the details of the journey (speed, route, rest stops, etc.) within the parameters of the contract. Customer does not have the right to continue using the truck after the specified trip is complete.*

*The cargo to be transported, and the timing and location of pick-up in New York and delivery in San Francisco, are specified in the contract.*

*Customer is responsible for driving the truck from New York to San Francisco.*

The contract contains a lease of a truck. Customer has the right to use the truck for the duration of the specified trip.

There is an identified asset. The truck is explicitly specified in the contract, and Supplier does not have the right to substitute the truck.

Customer has the right to control the use of the truck throughout the period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the truck over the period of use. Customer has exclusive use of the truck throughout the period of use.
- (b) Customer has the right to direct the use of the truck because the conditions in AG25(b)(i) exist. How and for what purpose the truck will be used (i.e., the transportation of specified cargo from New York to San Francisco within a specified timeframe) is predetermined in the contract. Customer directs the use of the truck because it has the right to operate the truck (for example, speed, route, rest stops) throughout the period of use. Customer makes all of the decisions about the use of the truck that can be made during the period of use through its control of the operations of the truck.

Because the duration of the contract is one week, this lease meets the definition of a short-term lease.

#### *Example 6—Ship*

*Example 6A: Customer enters into a contract with a ship owner (Supplier) for the transportation of cargo from Rotterdam to Sydney on a specified ship. The ship is explicitly specified in the contract and Supplier does not have substitution rights. The cargo will occupy substantially all of the capacity of the ship. The contract specifies the cargo to be transported on the ship and the dates of pickup and delivery.*

*Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship or operating the ship itself during the term of the contract.*

The contract does not contain a lease.

There is an identified asset. The ship is explicitly specified in the contract and Supplier does not have the right to substitute that specified ship.

Customer has the right to obtain substantially all of the economic benefits from use of the ship over the period of use. Its cargo will occupy substantially all of the capacity of the ship, thereby preventing other parties from obtaining economic benefits from use of the ship.

However, Customer does not have the right to control the use of the ship because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the ship is used. How and for what purpose the ship will be used (i.e., the transportation of specified cargo from Rotterdam to Sydney within a specified timeframe) is predetermined in the contract. Customer has no right to change how and for what purpose the ship is used during the period of use. Customer has no other decision-making rights about the use of the ship during the period of use (for example, it does not have the right to operate the ship) and did not design the ship.



Customer has the same rights regarding the use of the ship as if it were one of many customers transporting cargo on the ship.

*Example 6B: Customer enters into a contract with Supplier for the use of a specified ship for a five-year period. The ship is explicitly specified in the contract and Supplier does not have substitution rights.*

*Customer decides what cargo will be transported, and whether, when and to which ports the ship will sail, throughout the five-year period of use, subject to restrictions specified in the contract. Those restrictions prevent Customer from sailing the ship into waters at a high risk of piracy or carrying hazardous materials as cargo.*

*Supplier operates and maintains the ship and is responsible for the safe passage of the cargo on board the ship. Customer is prohibited from hiring another operator for the ship of the contract or operating the ship itself during the term of the contract.*

The contract contains a lease. Customer has the right to use the ship for five years.

There is an identified asset. The ship is explicitly specified in the contract, and Supplier does not have the right to substitute that specified ship.

Customer has the right to control the use of the ship throughout the five-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the ship over the five-year period of use. Customer has exclusive use of the ship throughout the period of use.
- (b) Customer has the right to direct the use of the ship because the conditions in paragraph AG25(a) exist. The contractual restrictions about where the ship can sail and the cargo to be transported by the ship define the scope of Customer's right to use the ship. They are protective rights that protect Supplier's investment in the ship and Supplier's personnel. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the ship is used throughout the five-year period of use because it decides whether, where and when the ship sails, as well as the cargo it will transport. Customer has the right to change these decisions throughout the five-year period of use.

Although the operation and maintenance of the ship are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the ship is used. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the ship is used.

#### *Example 7—Aircraft*

*Customer enters into a contract with an aircraft owner (Supplier) for the use of an explicitly specified aircraft for a two-year period. The contract details the interior and exterior specifications for the aircraft.*

*There are contractual and legal restrictions in the contract on where the aircraft can fly. Subject to those restrictions, Customer determines where and when the aircraft will fly, and which passengers and cargo will be transported on the aircraft. Supplier is responsible for operating the aircraft, using its own crew. Customer is prohibited from hiring another operator for the aircraft or operating the aircraft itself during the term of the contract.*

*Supplier is permitted to substitute the aircraft at any time during the two-year period and must substitute the aircraft if it is not working. Any substitute aircraft must meet the interior and exterior specifications in the contract. There are significant costs involved in outfitting an aircraft in Supplier's fleet to meet Customer's specifications.*

The contract contains a lease. Customer has the right to use the aircraft for two years.

There is an identified asset. The aircraft is explicitly specified in the contract and, although Supplier can substitute the aircraft, its substitution right is not substantive because the conditions in paragraph AG15(b) do not exist. Supplier's substitution right is not substantive because of the significant costs involved in outfitting another aircraft to meet the specifications required by the contract such that Supplier is not expected to benefit economically from substituting the aircraft.

Customer has the right to control the use of the aircraft throughout the two-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the aircraft over the two-year period of use. Customer has exclusive use of the aircraft throughout the period of use.
- (b) Customer has the right to direct the use of the aircraft because the conditions in paragraph AG25(a) exist. The restrictions on where the aircraft can fly define the scope of Customer's right to use the aircraft. Within the scope of its right of use, Customer makes the relevant decisions about how and for what purpose the aircraft is used throughout the two-year period of use because it decides whether, where and when the aircraft travels as well as the passengers and cargo it will transport. Customer has the right to change these decisions throughout the two-year period of use.

Although the operation of the aircraft is essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the aircraft is used. Consequently, Supplier does not control the use of the aircraft during the period of use and Supplier's decisions do not affect Customer's control of the use of the aircraft.

#### *Example 8—Contract for Shirts*

*Customer enters into a contract with a manufacturer (Supplier) to purchase a particular type, quality and quantity of shirts for a three-year period. The type, quality and quantity of shirts are specified in the contract.*

*Supplier has only one factory that can meet the needs of Customer. Supplier is unable to supply the shirts from another factory or source the shirts from a third party supplier. The capacity of the factory exceeds the output for which Customer has contracted (i.e., Customer has not contracted for substantially all of the capacity of the factory).*

*Supplier makes all decisions about the operations of the factory, including the production level at which to run the factory and which customer contracts to fulfil with the output of the factory that is not used to fulfil Customer's contract.*

The contract does not contain a lease.

The factory is an identified asset. The factory is implicitly specified because Supplier can fulfil the contract only through the use of this asset.

Customer does not control the use of the factory because it does not have the right to obtain substantially all of the economic benefits from use of the factory. This is because Supplier could decide to use the factory to fulfil other customer contracts during the period of use.

Customer also does not control the use of the factory because it does not have the right to direct the use of the factory. Customer does not have the right to direct how and for what purpose the factory is used during the three-year period of use. Customer's rights are limited to specifying output from the factory in the contract with Supplier. Customer has the same rights regarding the use of the factory as other customers purchasing shirts from the factory. Supplier has the right to direct the use of the factory because Supplier can decide how and for what purpose the factory is used (i.e., Supplier has the right to decide the production level at which to run the factory and which customer contracts to fulfil with the output produced).

Either the fact that Customer does not have the right to obtain substantially all of the economic benefits from use of the factory, or that Customer does not have the right to direct the use of the factory, would be sufficient in isolation to conclude that Customer does not control the use of the factory.

#### *Example 9—Contract for Energy/Power*

*Example 9A: a utility company (Customer) enters into a contract with a power company (Supplier) to purchase all of the electricity produced by a new solar farm for 20 years. The solar farm is explicitly specified in the contract and Supplier has no substitution rights. The solar farm is owned by Supplier and the energy cannot be provided to Customer from another asset. Customer designed the solar farm before it was constructed—Customer hired experts in solar energy to assist in determining the location of the farm and the engineering of the equipment to be used. Supplier is responsible for building the solar farm to Customer's specifications, and then operating and maintaining it. There are no decisions to be made about whether, when or how much electricity will be produced because the design of the asset has predetermined those decisions. Supplier will receive tax credits relating to the construction and ownership of the solar farm, while Customer receives renewable energy credits that accrue from use of the solar farm.*

The contract contains a lease. Customer has the right to use the solar farm for 20 years.

There is an identified asset because the solar farm is explicitly specified in the contract, and Supplier does not have the right to substitute the specified solar farm.

Customer has the right to control the use of the solar farm throughout the 20-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the solar farm over the 20-year period of use. Customer has exclusive use of the solar farm; it takes all of the electricity produced by the farm over the 20-year period of use as well as the renewable energy credits that are a by-product from use of the solar farm. Although Supplier will receive economic benefits from the solar farm in the form of tax credits, those economic benefits relate to the ownership of the solar farm rather than the use of the solar farm and, thus, are not considered in this assessment.
- (b) Customer has the right to direct the use of the solar farm because the conditions in paragraph AG25(b)(ii) exist. Neither Customer, nor Supplier, decides how and for what purpose the

solar farm is used during the period of use because those decisions are predetermined by the design of the asset (i.e., the design of the solar farm has, in effect, programmed into the asset any relevant decision-making rights about how and for what purpose the solar farm is used throughout the period of use). Customer does not operate the solar farm; Supplier makes the decisions about the operation of the solar farm. However, Customer's design of the solar farm has given it the right to direct the use of the farm. Because the design of the solar farm has predetermined how and for what purpose the asset will be used throughout the period of use, Customer's control over that design is substantively no different from Customer controlling those decisions.

*Example 9B: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for three years. The power plant is owned and operated by Supplier. Supplier is unable to provide power to Customer from another plant. The contract sets out the quantity and timing of power that the power plant will produce throughout the period of use, which cannot be changed in the absence of extraordinary circumstances (for example, emergency situations). Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices. Supplier designed the power plant when it was constructed some years before entering into the contract with Customer—Customer had no involvement in that design.*

The contract does not contain a lease.

There is an identified asset because the power plant is explicitly specified in the contract, and Supplier does not have the right to substitute the specified plant.

Customer has the right to obtain substantially all of the economic benefits from use of the identified power plant over the three-year period of use. Customer will take all of the power produced by the power plant over the three-year period of use.

However, Customer does not have the right to control the use of the power plant because it does not have the right to direct its use. Customer does not have the right to direct how and for what purpose the plant is used. How and for what purpose the plant is used (i.e., whether, when and how much power the plant will produce) is predetermined in the contract. Customer has no right to change how and for what purpose the plant is used during the period of use. Customer has no other decision-making rights about the use of the power plant during the period of use (for example, it does not operate the power plant) and did not design the plant. Supplier is the only party that can make decisions about the plant during the period of use by making the decisions about how the plant is operated and maintained. Customer has the same rights regarding the use of the plant as if it were one of many customers obtaining power from the plant.

*Example 9C: Customer enters into a contract with Supplier to purchase all of the power produced by an explicitly specified power plant for 10 years. The contract states that Customer has rights to all of the power produced by the plant (i.e., Supplier cannot use the plant to fulfil other contracts).*

*Customer issues instructions to Supplier about the quantity and timing of the delivery of power. If the plant is not producing power for Customer, it does not operate.*

*Supplier operates and maintains the plant on a daily basis in accordance with industry-approved operating practices.*

The contract contains a lease. Customer has the right to use the power plant for 10 years.

There is an identified asset. The power plant is explicitly specified in the contract and Supplier does not have the right to substitute the specified plant.

Customer has the right to control the use of the power plant throughout the 10-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the power plant over the 10-year period of use. Customer has exclusive use of the power plant; it has rights to all of the power produced by the power plant throughout the 10-year period of use.
- (b) Customer has the right to direct the use of the power plant because the conditions in paragraph AG25(a) exist. Customer makes the relevant decisions about how and for what purpose the power plant is used because it has the right to determine whether, when and how much power the plant will produce (i.e., the timing and quantity, if any, of power produced) throughout the period of use. Because Supplier is prevented from using the power plant for another purpose, Customer's decision-making about the timing and quantity of power produced, in effect, determines when, and whether, the plant produces output.

Although the operation and maintenance of the power plant are essential to its efficient use, Supplier's decisions in this regard do not give it the right to direct how and for what purpose the power plant is used. Consequently, Supplier does not control the use of the power plant during the period of use. Instead, Supplier's decisions are dependent upon Customer's decisions about how and for what purpose the power plant is used.

#### *Example 10—Contract for Network Services*

*Example 10A: Customer enters into a contract with a telecommunications company (Supplier) for network services for two years. The contract requires Supplier to supply network services that meet a specified quality level. In order to provide the services, Supplier installs and configures servers at Customer's premises—Supplier determines the speed and quality of data transportation in the network using the servers. Supplier can reconfigure or replace the servers when needed to continuously provide the quality of network services defined in the contract. Customer does not operate the servers or make any significant decisions about their use.*

The contract does not contain a lease. Instead, the contract is a service contract in which Supplier uses the equipment to meet the level of network services determined by Customer.

There is no need to assess whether the servers installed at Customer's premises are identified assets. This assessment would not change the analysis of whether the contract contains a lease because Customer does not have the right to control the use of the servers.

Customer does not control the use of the servers because Customer's only decision-making rights relate to deciding upon the level of network services (the output of the servers) before the period of use—the level of network services cannot be changed during the period of use without modifying the contract. For example, even though Customer produces the data to be transported, that activity does not directly affect the configuration of the network services and, thus, it does not affect how and for what purpose the servers are used.

Supplier is the only party that can make relevant decisions about the use of the servers during the period of use. Supplier has the right to decide how data is transported using the servers, whether to reconfigure the servers and whether to use the servers for another purpose. Accordingly, Supplier controls the use of the servers in providing network services to Customer.

*Example 10B: Customer enters into a contract with an information technology company (Supplier) for the use of an identified server for three years. Supplier delivers and installs the server at Customer's premises in accordance with Customer's instructions, and provides repair and maintenance services for the server, as needed, throughout the period of use. Supplier substitutes the server only in the case of malfunction. Customer decides which data to store on the server and how to integrate the server within its operations. Customer can change its decisions in this regard throughout the period of use.*

The contract contains a lease. Customer has the right to use the server for three years.

There is an identified asset. The server is explicitly specified in the contract. Supplier can substitute the server only if it is malfunctioning (see paragraph AG19).

Customer has the right to control the use of the server throughout the three-year period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from use of the server over the three-year period of use. Customer has exclusive use of the server throughout the period of use.
- (b) Customer has the right to direct the use of the server (because the conditions in paragraph AG25(a) exist). Customer makes the relevant decisions about how and for what purpose the server is used because it has the right to decide which aspect of its operations the server is used to support and which data it stores on the server. Customer is the only party that can make decisions about the use of the server during the period of use.

### **Leases of Low-Value Assets and Portfolio Application (see paragraphs 6–7, AG1 and AG4–AG9)**

IE3. The following example illustrates how a lessee might (a) apply paragraphs AG4–AG9 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to leases of low-value assets; and (b) determine portfolios of leases to which it would apply the requirements in ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]).

#### *Example 11— Leases of Low-Value Assets and Portfolio Application*

*A lessee in the pharmaceutical manufacturing and distribution industry (Lessee) has the following leases:*

- (a) *Leases of real estate (both office buildings and warehouses).*
- (b) *Leases of manufacturing equipment.*
- (c) *Leases of company cars, both for sales personnel and senior management and of varying quality, specification and value.*
- (d) *Leases of trucks and vans used for delivery purposes, of varying size and value.*
- (e) *Leases of IT equipment for use by individual employees (such as laptop computers, desktop computers, hand held computer devices, desktop printers and mobile phones).*

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- (f) *Leases of servers, including many individual modules that increase the storage capacity of those servers. The modules have been added to the mainframe servers over time as Lessee has needed to increase the storage capacity of the servers.*
- (g) *Leases of office equipment:*
  - (i) *Office furniture (such as chairs, desks and office partitions);*
  - (ii) *Water dispensers; and*
  - (iii) *High-capacity multifunction photocopier devices.*

Leases of low-value assets

Lessee determines that the following leases qualify as leases of low-value assets on the basis that the underlying assets, when new, are individually of low value:

- (a) Leases of IT equipment for use by individual employees; and
- (b) Leases of office furniture and water dispensers.

Lessee elects to apply the requirements in paragraph 7 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) in accounting for all of those leases.

Although each module within the servers, if considered individually, might be an asset of low value, the leases of modules within the servers do not qualify as leases of low-value assets. This is because each module is highly interrelated with other parts of the servers. Lessee would not lease the modules without also leasing the servers.

Portfolio application

As a result, Lessee applies the recognition and measurement requirements in ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to its leases of real estate, manufacturing equipment, company cars, trucks and vans, servers and high-capacity multifunction photocopier devices. In doing so, Lessee groups its company cars, trucks and vans into portfolios.

Lessee's company cars are leased under a series of master lease agreements. Lessee uses eight different types of company car, which vary by price and are assigned to staff on the basis of seniority and territory. Lessee has a master lease agreement for each different type of company car. The individual leases within each master lease agreement are all similar (including similar start and end dates), but the terms and conditions generally vary from one master lease agreement to another. Because the individual leases within each master lease agreement are similar to each other, Lessee reasonably expects that applying the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to each master lease agreement would not result in a materially different effect than applying the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to each individual lease within the master lease agreement. Consequently, Lessee concludes that it can apply the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to each master lease agreement as a portfolio. In addition, Lessee concludes that two of the eight master lease agreements are similar and cover substantially similar types of company cars in similar territories. Lessee reasonably expects that the effect of applying ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to the combined portfolio of leases within the two master lease agreements would not differ materially from applying ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to each lease within that combined portfolio. Lessee, therefore, concludes that it can further combine those two master lease agreements into a single lease portfolio.

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Lessee's trucks and vans are leased under individual lease agreements. There are 6,500 leases in total. All of the truck leases have similar terms, as do all of the van leases. The truck leases are generally for four years and involve similar models of truck. The van leases are generally for five years and involve similar models of van. Lessee reasonably expects that applying the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to portfolios of truck leases and van leases, grouped by type of underlying asset, territory and the quarter of the year within which the lease was entered into, would not result in a materially different effect from applying those requirements to each individual truck or van lease. Consequently, Lessee applies the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to different portfolios of truck and van leases, rather than to 6,500 individual leases.

### **Allocating Consideration to Components of a Contract (see paragraphs 13–17 and AG33–AG34)**

IE4. The following example illustrates the allocation of consideration in a contract to lease and non-lease components by a lessee.

#### *Example 12—Lessee Allocation of Consideration to Lease and Non-Lease Components of a Contract*

*Lessor leases a bulldozer, a truck and a long-reach excavator to Lessee to be used in Lessee's mining operations for four years. Lessor also agrees to maintain each item of equipment throughout the lease term. The total consideration in the contract is CU600,000<sup>(a)</sup>, payable in annual instalments of CU150,000, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. The variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. The consideration includes the cost of maintenance services for each item of equipment.*

Lessee accounts for the non-lease components (maintenance services) separately from each lease of equipment applying paragraph 13 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]). Lessee does not elect the practical expedient in paragraph 16 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]). Lessee considers the requirements in paragraph AG33 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) and concludes that the lease of the bulldozer, the lease of the truck and the lease of the long-reach excavator are each separate lease components. This is because:

- (a) Lessee can benefit from use of each of the three items of equipment on its own or together with other readily available resources (for example, Lessee could readily lease or purchase an alternative truck or excavator to use in its operations); and
- (b) Although Lessee is leasing all three items of equipment for one purpose (i.e., to engage in mining operations), the machines are neither highly dependent on, nor highly interrelated with, each other. Lessee's ability to derive benefit from the lease of each item of equipment is not significantly affected by its decision to lease, or not lease, the other equipment from Lessor.

Consequently, Lessee concludes that there are three lease components and three non-lease components (maintenance services) in the contract. Lessee applies the guidance in paragraphs 14–15 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) to allocate the consideration in the contract to the three lease components and the non-lease components.

*Several suppliers provide maintenance services for a similar bulldozer and a similar truck. Accordingly, there are observable standalone prices for the maintenance services for those two items of leased equipment. Lessee is able to establish observable stand-alone prices for the*



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*maintenance of the bulldozer and the truck of CU32,000 and CU16,000, respectively, assuming similar payment terms to those in the contract with Lessor. The long-reach excavator is highly specialized and, accordingly, other suppliers do not lease or provide maintenance services for similar excavators. Nonetheless, Lessor provides four-year maintenance service contracts to customers that purchase similar long-reach excavators from Lessor. The observable consideration for those four-year maintenance service contracts is a fixed amount of CU56,000, payable over four years, and a variable amount that depends on the hours of work performed in maintaining the long-reach excavator. That variable payment is capped at 2 per cent of the replacement cost of the long-reach excavator. Consequently, Lessee estimates the stand-alone price of the maintenance services for the long-reach excavator to be CU56,000 plus any variable amounts. Lessee is able to establish observable stand-alone prices for the leases of the bulldozer, the truck and the long-reach excavator of CU170,000, CU102,000 and CU224,000, respectively.*

Lessee allocates the fixed consideration in the contract (CU600,000) to the lease and non-lease components as follows:

<b>CU</b>	<b>Bulldozer</b>	<b>Truck</b>	<b>Long-reach excavator</b>	<b>Total</b>
<b>Lease</b>	170.000	102.000	224.000	<b>496.000</b>
<b>Non-lease</b>				<b>104.000</b>
<b>Total fixed consideration</b>				<b>600.000</b>

Lessee allocates all of the variable consideration to the maintenance of the long-reach excavator, and, thus, to the non-lease components of the contract. Lessee then accounts for each lease component applying the guidance in ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]), treating the allocated consideration as the lease payments for each lease component.

(a) In these Illustrative Examples, currency amounts are denominated in 'currency units' (CU).

### **Lessee Measurement (see paragraphs 19–46 and AG35–AG42)**

IE5. The following example illustrates how a lessee measures right-of-use assets and lease liabilities. It also illustrates how a lessee accounts for a change in the lease term.

#### *Example 13—Measurement by a Lessee and Accounting for a Change in the Lease Term*

##### *Part 1—Initial measurement of the right-of-use asset and the lease liability*

*Lessee enters into a 10-year lease of a floor of a building, with an option to extend for five years. Lease payments are CU50,000 per year during the initial term and CU55,000 per year during the optional period, all payable at the beginning of each year. To obtain the lease, Lessee incurs initial direct costs of CU20,000, of which CU15,000 relates to a payment to a former tenant occupying that floor of the building and CU5,000 relates to a commission paid to the real estate agent that arranged the lease. As an incentive to Lessee for entering into the lease, Lessor agrees to reimburse to Lessee the real estate commission of CU5,000 and Lessee's leasehold improvements of CU7,000.*

*At the commencement date, Lessee concludes that it is not reasonably certain to exercise the option to extend the lease and, therefore, determines that the lease term is 10 years.*

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*The interest rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.*

At the commencement date, Lessee makes the lease payment for the first year, incurs initial direct costs, receives lease incentives from Lessor and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391	
Lease liability		CU355,391
Cash (lease payment for the first year)		CU50,000
Right-of-use asset	CU20,000	
Cash (initial direct costs)		CU20,000
Cash (lease incentive)	CU5,000	
Right-of-use asset		CU5,000

Lessee accounts for the reimbursement of leasehold improvements from Lessor applying other relevant Standards and not as a lease incentive applying ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]). This is because costs incurred on leasehold improvements by Lessee are not included within the cost of the right-of-use asset.

*Part 2—Subsequent measurement and accounting for a change in the lease term*

*In the sixth year of the lease, Lessee acquires Entity A. Entity A has been leasing a floor in another building. The lease entered into by Entity A contains a termination option that is exercisable by Entity A. Following the acquisition of Entity A, Lessee needs two floors in a building suitable for the increased workforce. To minimize costs, Lessee (a) enters into a separate eight-year lease of another floor in the building leased that will be available for use at the end of Year 7 and (b) terminates early the lease entered into by Entity A with effect from the beginning of Year 8.*

Moving Entity A's staff to the same building occupied by Lessee creates an economic incentive for Lessee to extend its original lease at the end of the non-cancellable period of 10 years. The acquisition of Entity A and the relocation of Entity A's staff is a significant event that is within the control of Lessee and affects whether Lessee is reasonably certain to exercise the extension option not previously included in its determination of the lease term. This is because the original floor has greater utility (and thus provides greater benefits) to Lessee than alternative assets that could be leased for a similar amount to the lease payments for the optional period—Lessee would incur additional costs if it were to lease a similar floor in a different building because the workforce would be located in different buildings. Consequently, at the end of Year 6, Lessee concludes that it is now reasonably certain to exercise the option to extend its original lease as a result of its acquisition and planned relocation of Entity A.

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*Lessee's incremental borrowing rate at the end of Year 6 is 6 per cent per annum, which reflects the fixed rate at which Lessee could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a nine-year term, and with similar collateral. Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.*

The right-of-use asset and the lease liability from Year 1 to Year 6 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance CU	Lease payment CU	5% interest expense CU	Ending balance CU	Beginning balance CU	Depreciation charge CU	Ending balance CU
1	355,391	-	17,770	373,161	420,391	(42,039)	378,352
2	373,161	(50,000)	16,158	339,319	378,352	(42,039)	336,313
3	339,319	(50,000)	14,466	303,785	336,313	(42,039)	294,274
4	303,785	(50,000)	12,689	266,474	294,274	(42,039)	252,235
5	266,474	(50,000)	10,823	227,297	252,235	(42,039)	210,196
6	227,297	(50,000)	8,865	186,162	210,196	(42,039)	168,157

At the end of the sixth year, before accounting for the change in the lease term, the lease liability is CU186,162 (the present value of four remaining payments of CU50,000, discounted at the original interest rate of 5 per cent per annum). Interest expense of CU8,865 is recognized in Year 6. Lessee's right-of-use asset is CU168,157.

Lessee remeasures the lease liability at the present value of four payments of CU50,000 followed by five payments of CU55,000, all discounted at the revised discount rate of 6 per cent per annum, which is CU378,174. Lessee increases the lease liability by CU192,012, which represents the difference between the remeasured liability of CU378,174 and its previous carrying amount of CU186,162. The corresponding adjustment is made to the right-of-use asset to reflect the cost of the additional right of use, recognized as follows.

Right-of-use asset	CU192,012
Lease liability	CU192,012

Following the remeasurement, the carrying amount of Lessee's right-of-use asset is CU360,169 (i.e., CU168,157 + CU192,012). From the beginning of Year 7 Lessee calculates the interest expense on the lease liability at the revised discount rate of 6 per cent per annum.

The right-of-use asset and the lease liability from Year 7 to Year 15 are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance CU	Lease payment CU	6% interest expense CU	Ending balance CU	Beginning balance CU	Depreciation charge CU	Ending balance CU
7	378,174	(50,000)	19,690	347,864	360,169	(40,019)	320,150

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8	347,864	(50,000)	17,872	315,736	320,150	(40,019)	280,131
9	315,736	(50,000)	15,944	281,680	280,131	(40,019)	240,112
10	281,680	(50,000)	13,901	245,581	240,112	(40,019)	200,093
11	245,581	(55,000)	11,435	202,016	200,093	(40,019)	160,074
12	202,016	(55,000)	8,821	155,837	160,074	(40,019)	120,055
13	155,837	(55,000)	6,050	106,887	120,055	(40,019)	80,036
14	106,887	(55,000)	3,113	55,000	80,036	(40,018)	40,018
15	55,000	(55,000)	-	-	40,018	(40,018)	-

**Concessionary lease (see paragraphs 25, 30, 41, 58 and 63)**

IE6. The following example illustrates how a lessee accounts for a concessionary lease.

**Example 14—Concessionary Lease (lessee)**

A municipality (lessee) enters into a lease with central government (lessor) to use equipment over a period of 5 years. The fair value of the right-of-use asset is CU5 million.

- The agreement stipulates that the lease should be paid over the 5 year period as follows:  
Year 1: CU1.155.874  
Year 2: CU1.155.874  
Year 3: CU1.155.874  
Year 4: CU1.155.874  
Year 5: CU1.155.874
- The interest rate implicit in the lease is 5% per annum on the outstanding balance of the loan. A market related rate of interest for a similar lease transaction is 10%.
- The lease includes conditions. To the extent the conditions are not met, the lease is cancelled and the right to use the underlying asset returns to the lessor. The conditions are met on a straight-line basis.

**Analysis**

The municipality has effectively received a grant of CU622 (which is the difference between the present value of the contractual cash flows of the lease, discounted using the market related rate of interest of 10% and the present value of the contractual cash flows of the lease, discounted using the interest rate implicit in the lease of 5% or the difference between the fair value of the right-of-use asset and the present value of the contractual cash flows of the lease, discounted using the market related rate of interest of 10%). (Note: An entity would consider whether the substance of the CU622.119 is a contribution from owners or revenue; assume for purposes of this example that the CU622.119 is revenue).

The grant of CU622.119 is accounted for in accordance with IPSAS 23 and, the lease with its related contractual interest and capital payments, in accordance with this [draft] Standard.

The journal entries to account for the concessionary lease are as follows:

1. On initial recognition, the entity recognizes the following (the entity subsequently measures concessionary lease at amortized cost):

Dr	Right-of-use asset	5,000,000	-
	Cr	Lease liability (refer to Table 2 below)	4,377,881
	Cr	Liability or non-exchange revenue	622,119

Recognition of the receipt of the loan at fair value

IPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the loan. Paragraph IG55 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the lease deemed to be non-exchange revenue.

2. Year 1: The entity recognizes the following:

Dr	Interest (refer to Table 3 below)	437,788	-
	Cr	Lease liability	437,788

Recognition of interest using the effective interest method (CU4,377,881 × 10%)

Dr	Lease liability (refer to Table 1 below)	1,154,874	-
	Cr	Bank	1,154,874

Recognition of interest paid on outstanding balance (CU5,000,000 × 5% + CU904,874 principal paid)

3. Year 2: The entity recognizes the following:

Dr	Interest	366,080	-
	Cr	Lease liability	366,080

Recognition of interest using the effective interest method (CU4,095,126 × 10%)

Dr	Lease liability	1,154,874	-
	Cr	Bank	1,154,874

Recognition of interest paid on outstanding balance (CU5m × 5% + CU950,118 principal paid)

4. Year 3: The entity recognizes the following:

Dr	Interest	287,200	-
	Cr	Lease liability	287,200

Recognition of interest using the effective interest method (CU4,075,695 × 10%)

Dr	Lease liability	1,154,874	-
	Cr	Bank	1,154,874

Recognition of interest paid on outstanding balance (CU3,145,008 × 5% + CU997,624 principal paid)

5. Year 4: The entity recognizes the following:

Dr	Interest	200,433	-
	Cr	Lease liability	200,433

Recognition of interest using the effective interest method (CU 3,258,264 × 10%)

Dr	Lease liability	1,154,874	-
	Cr	Bank	1,154,874

Recognition of interest paid on outstanding balance (CU2,147,385 × 5% + CU1,047,505 principal paid)

6. Year 5: The entity recognizes the following:

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Dr	Interest	104,989	-
	Cr Lease liability	-	104,989

*Recognition of interest using the effective interest method (CU1,909,091 × 10%)*

Dr	Lease liability	1,154,874	
	Cr Bank	-	1,154,874

*Recognition of interest paid on outstanding balance (CU1,099,880 × 5% + CU1,099,880 principal paid)*

Calculations:**Table 1: Amortization Schedule (Using Contractual Repayments at 5% Interest)**

	<u>Year 1</u> <u>CU</u>	<u>Year 2</u> <u>CU</u>	<u>Year 3</u> <u>CU</u>	<u>Year 4</u> <u>CU</u>	<u>Year 5</u> <u>CU</u>
<b>Opening Balance</b>	<b>5,000,000</b>	<b>4,095,126</b>	<b>3,145,008</b>	<b>2,147,385</b>	<b>1,099,880</b>
Capital	904,874	950,118	997,624	1,047,505	1,099,880
Interest	250,000	204,756	157,250	107,369	54,994
Payments	(1,154,874)	(1,154,874)	(1,154,874)	(1,154,874)	(1,154,874)
<b>Closing Balance</b>	<b>4,095,126</b>	<b>3,145,008</b>	<b>2,147,385</b>	<b>1,099,880</b>	<b>=</b>

**Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 10%)**

	<u>Year 1</u> <u>CU</u>	<u>Year 2</u> <u>CU</u>	<u>Year 3</u> <u>CU</u>	<u>Year 4</u> <u>CU</u>	<u>Year 5</u> <u>CU</u>
Capital balance	4,095,126	3,145,008	2,147,385	1,099,880	=
Interest payable	250,000	204,756	157,250	107,369	54,994
Total payments (capital and interest)	1,154,874	1,154,874	1,154,874	1,154,874	1,154,874
Present value of lease payments	1,049,885	954,441	867,674	788,794	717,086
Total present value of lease payments					<u>4,377,881</u>
Right-of-use asset					5,000,000
Less: Present value of outflows (fair value of lease liability on initial recognition)					<u>4,377,881</u>
Off-market portion of loan to be recognized as non-exchange revenue					<u>622,119</u>

**Table 3: Calculation of Lease Liability Balance and Interest Using the Effective Interest Method**

	<u>Year 1</u> <u>CU</u>	<u>Year 2</u> <u>CU</u>	<u>Year 3</u> <u>CU</u>	<u>Year 4</u> <u>CU</u>	<u>Year 5</u> <u>CU</u>
Capital	4,377,881	3,660,795	2,872,001	2,004,327	1,049,885
Interest accrual	437,788	366,080	287,200	200,433	104,989
Interest and capital payments	1,154,874	1,154,874	1,154,874	1,154,874	1,154,874
<b>Balance</b>	<b>3,660,795</b>	<b>2,872,001</b>	<b>2,004,327</b>	<b>1,049,885</b>	<b>=</b>

**Example 15—Concessionary Lease (lessor)**

An agency of central government (lessor) enters into a lease with a municipality (lessee) by granting the right to use its equipment over a period of 5 years. The fair value of the right-of-use asset is CU5 million.

- The agreement stipulates that the lease should be paid over the 5 year period as follows:  
Year 1: CU1.155.874  
Year 2: CU1.155.874  
Year 3: CU1.155.874  
Year 4: CU1.155.874  
Year 5: CU1.155.874
- The interest rate implicit in the lease is 5% per annum on the outstanding balance of the loan. A market related rate of interest for a similar lease transaction is 10%.
- The lease includes conditions. To the extent the conditions are not met, the lease is cancelled and the right to use the underlying asset returns to the lessor. The conditions are met on a straight-line basis.

**Analysis**

The agency has effectively transferred a grant of CU622 (which is the difference between the present value of the contractual cash flows of the lease, discounted using the market related rate of interest of 10% and the present value of the contractual cash flows of the lease, discounted using the interest rate implicit in the lease of 5% or the difference between the fair value of the right-of-use asset and the present value of the contractual cash flows of the lease, discounted using the market related rate of interest of 10%).

The grant of CU622.119 is accounted for in accordance with IPSAS 23 and, the lease with its related contractual interest and capital payments, in accordance with this [draft] Standard.

The journal entries to account for the concessionary lease are as follows:

[To be discussed at the September 2017 meeting]

**Variable Lease Payments (see paragraphs 31, 44, 47(b) and 48)**

- IE7. The following example illustrates how a lessee accounts for variable lease payments that depend on an index and variable lease payments not included in the measurement of the lease liability.

**Example 4416—Variable Lease Payments Dependent on an Index and Variable Lease Payments Linked to Sales**

Example 44A16A—Lessee enters into a 10-year lease of property with annual lease payments of CU50,000, payable at the beginning of each year. The contract specifies that lease payments will increase every two years on the basis of the increase in the Consumer Price Index for the preceding 24 months. The Consumer Price Index at the commencement date is 125. This example ignores any initial direct costs. The rate implicit in the lease is not readily determinable. Lessee's incremental borrowing rate is 5 per cent per annum, which reflects the fixed rate at which Lessee

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*could borrow an amount similar to the value of the right-of-use asset, in the same currency, for a 10-year term, and with similar collateral.*

At the commencement date, Lessee makes the lease payment for the first year and measures the lease liability at the present value of the remaining nine payments of CU50,000, discounted at the interest rate of 5 per cent per annum, which is CU355,391.

Lessee initially recognizes assets and liabilities in relation to the lease as follows.

Right-of-use asset	CU405,391
Lease liability	CU355,391
Cash (lease payment for the first year)	CU50,000

*Lessee expects to consume the right-of-use asset's future economic benefits evenly over the lease term and, thus, depreciates the right-of-use asset on a straight-line basis.*

During the first two years of the lease, Lessee recognizes in aggregate the following related to the lease.

Interest expense	CU33,928
Lease liability	CU33,928
Depreciation charge	CU81,078 (CU405,391 ÷ 10 × 2 years)
Right-of-use asset	CU81,078

At the beginning of the second year, Lessee makes the lease payment for the second year and recognizes the following.

Lease liability	CU50,000
Cash	CU50,000

At the beginning of the third year, before accounting for the change in future lease payments resulting from a change in the Consumer Price Index and making the lease payment for the third year, the lease liability is CU339,319 (the present value of eight payments of CU50,000 discounted at the interest rate of 5 per cent per annum = CU355,391 + CU33,928 – CU50,000).

*At the beginning of the third year of the lease the Consumer Price Index is 135.*

The payment for the third year, adjusted for the Consumer Price Index, is CU54,000 (CU50,000 × 135 ÷ 125). Because there is a change in the future lease payments resulting from a change in the Consumer Price Index used to determine those payments, Lessee remeasures the lease liability to reflect those revised lease payments, i.e. the lease liability now reflects eight annual lease payments of CU54,000.

At the beginning of the third year, Lessee remeasures the lease liability at the present value of eight payments of CU54,000 discounted at an unchanged discount rate of 5 per cent per annum, which is CU366,464. Lessee increases the lease liability by CU27,145, which represents the difference between the remeasured liability of CU366,464 and its previous carrying amount of CU339,319. The corresponding adjustment is made to the right-of-use asset, recognized as follows.

Right-of-use asset	CU27,145
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Lease liability	CU27,145
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At the beginning of the third year, Lessee makes the lease payment for the third year and recognizes the following.

Lease liability	CU54,000
Cash	CU54,000

*Example 14B16B—Assume the same facts as Example 14A except that Lessee is also required to make variable lease payments for each year of the lease, which are determined as 1 per cent of Lessee's sales generated from the leased property.*

At the commencement date, Lessee measures the right-of-use asset and the lease liability recognized at the same amounts as in Example 14A. This is because the additional variable lease payments are linked to future sales and, thus, do not meet the definition of lease payments. Consequently, those payments are not included in the measurement of the asset and liability.

Right-of-use asset	CU405,391
Lease liability	CU355,391
Cash (lease payment for the first year)	CU50,000

*Lessee prepares financial statements on an annual basis. During the first year of the lease, Lessee generates sales of CU800,000 from the leased property.*

Lessee incurs an additional expense related to the lease of CU8,000 (CU800,000 × 1 per cent), which Lessee recognizes in profit or loss in the first year of the lease.

### Lease Modifications (see paragraphs 49–51)

IE8. Examples ~~15–19~~ 17–21 illustrate the requirements of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) regarding lease modifications for a lessee.

*Example 1517—Modification that is a Separate Lease*

*Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space, adjusted for the discount that Lessee receives reflecting that Lessor does not incur costs that it would otherwise have incurred if leasing the same space to a new tenant (for example, marketing costs).*

Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract. In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a right-of-use asset and a lease liability relating to the lease of the additional 3,000

square metres of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square metres of office space as a result of this modification.

**Example 4618—Modification that Increases the Scope of the Lease by Extending the Contractual Lease Term**

*Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., CU100,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7 per cent per annum.*

At the effective date of the modification (at the beginning of Year 7), Lessee remeasures the lease liability based on: (a) an eight-year remaining lease term, (b) annual payments of CU100,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified lease liability equals CU597,130. The lease liability immediately before the modification (including the recognition of the interest expense until the end of Year 6) is CU346,511. Lessee recognizes the difference between the carrying amount of the modified lease liability and the carrying amount of the lease liability immediately before the modification (CU250,619) as an adjustment to the right-of-use asset.

**Example 4719—Modification that Decreases the Scope of the Lease**

*Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are CU50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are CU30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5 per cent per annum.*

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU30,000 and (c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU129,884.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (i.e., 2,500 square metres corresponding to 50 per cent of the original right-of-use asset).

50 per cent of the pre-modification right-of-use asset (CU184,002) is CU92,001. Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309. Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,001 and the carrying amount of the lease liability by CU105,309. Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 – CU92,001 = CU13,308) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee recognizes the difference between the remaining lease liability of CU105,309 and the modified lease liability of CU129,884 (which equals CU24,575) as an adjustment to the right-of-use asset reflecting the change in the consideration paid for the lease and the revised discount rate.

**Example 4820—Modification that Both Increases and Decreases the Scope of the Lease**

Lessee enters into a 10-year lease for 2,000 square metres of office space. The annual lease payments are CU100,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to (a) include an additional 1,500 square metres of space in the same building starting from the beginning of Year 6 and (b) reduce the lease term from 10 years to eight years. The annual fixed payment for the 3,500 square metres is CU150,000 payable at the end of each year (from Year 6 to Year 8). Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum.

The consideration for the increase in scope of 1,500 square metres of space is not commensurate with the stand-alone price for that increase adjusted to reflect the circumstances of the contract. Consequently, Lessee does not account for the increase in scope that adds the right to use an additional 1,500 square metres of space as a separate lease.

The pre-modification right-of-use asset and the pre-modification lease liability in relation to the lease are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance	6% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
1	736,009	44,160	(100,000)	680,169	736,009	(73,601)	662,408
2	680,169	40,810	(100,000)	620,979	662,408	(73,601)	588,807
3	620,979	37,259	(100,000)	558,238	588,807	(73,601)	515,206
4	558,238	33,494	(100,000)	491,732	515,206	(73,601)	441,605
5	491,732	29,504	(100,000)	421,236	441,605	(73,601)	368,004
6	421,236				368,004		

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability on the basis of: (a) a three-year remaining lease term, (b) annual payments of CU150,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. The modified liability equals CU393,647, of which (a) CU131,216 relates to the increase of CU50,000 in the annual lease payments from Year 6 to Year 8 and (b) CU262,431 relates to the remaining three annual lease payments of CU100,000 from Year 6 to Year 8.

**Decrease in the lease term**

At the effective date of the modification (at the beginning of Year 6), the pre-modification right-of-use asset is CU368,004. Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset based on the remaining right-of-use asset for the original 2,000 square metres of office space (i.e., a remaining three-year lease term rather than the original five-year

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lease term). The remaining right-of-use asset for the original 2,000 square metres of office space is CU220,802 (i.e.,  $CU368,004 \div 5 \times 3$  years).

At the effective date of the modification (at the beginning of Year 6), the pre-modification lease liability is CU421,236. The remaining lease liability for the original 2,000 square metres of office space is CU267,301 (i.e., present value of three annual lease payments of CU100,000, discounted at the original discount rate of 6 per cent per annum).

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU147,202 ( $CU368,004 - CU220,802$ ), and the carrying amount of the lease liability by CU153,935 ( $CU421,236 - CU267,301$ ). Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset ( $CU153,935 - CU147,202 = CU6,733$ ) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lease liability	CU153,935	
Right-of-use asset		CU147,202
Gain		CU6,733

At the effective date of the modification (at the beginning of Year 6), Lessee recognises the effect of the remeasurement of the remaining lease liability reflecting the revised discount rate of 7 per cent per annum, which is CU4,870 ( $CU267,301 - CU262,431$ ), as an adjustment to the right-of-use asset.

Lease liability	CU4,870	
Right-of-use asset		CU4,870

Increase in the leased space

At the commencement date of the lease for the additional 1,500 square metres of space (at the beginning of Year 6), Lessee recognizes the increase in the lease liability related to the increase in scope of CU131,216 (i.e., present value of three annual lease payments of CU50,000, discounted at the revised interest rate of 7 per cent per annum) as an adjustment to the right-of-use asset.

Right-of-use asset	CU131,216	
Lease liability		CU131,216

The modified right-of-use asset and the modified lease liability in relation to the modified lease are as follows.

Year	Lease liability				Right-of-use asset		
	Beginning balance	7% interest expense	Lease payment	Ending balance	Beginning balance	Depreciation charge	Ending balance
	CU	CU	CU	CU	CU	CU	CU
6	393,647	27,556	(150,000)	271,203	347,148	(115,716)	231,432
7	271,203	18,984	(150,000)	140,187	231,432	(115,716)	115,716
8	140,187	9,813	(150,000)	-	115,716	(115,716)	-

**Example 1921—Modification that is a Change in Consideration Only**

*Lessee enters into a 10-year lease for 5,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to reduce the lease payments from CU100,000 per year to CU95,000 per year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6 per cent per annum. Lessee's incremental borrowing rate at the beginning of Year 6 is 7 per cent per annum. The annual lease payments are payable at the end of each year.*

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on: (a) a five-year remaining lease term, (b) annual payments of CU95,000 and (c) Lessee's incremental borrowing rate of 7 per cent per annum. Lessee recognises the difference between the carrying amount of the modified liability (CU389,519) and the lease liability immediately before the modification (CU421,236) of CU31,717 as an adjustment to the right-of-use asset.

**Subleases (see paragraph AG60–AG61)**

IE9. Examples 20–24 22 illustrate the application of the requirements in ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) for an intermediate lessor that enters into a head lease and a sublease of the same underlying asset.

**~~Example 20—Sublease classified as a finance lease~~**

~~Head lease—An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).~~

~~Sublease—At the beginning of Year 3, the intermediate lessor subleases the 5,000 square metres of office space for the remaining three years of the head lease to a sublessee.~~

~~The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as a finance lease, having considered the requirements in paragraphs 61–66 of IFRS 16.~~

~~When the intermediate lessor enters into the sublease, the intermediate lessor:~~

- ~~(a) Derecognizes the right-of-use asset relating to the head lease that it transfers to the sublessee and recognizes the net investment in the sublease;~~
- ~~(b) Recognizes any difference between the right-of-use asset and the net investment in the sublease in profit or loss; and~~
- ~~(c) Retains the lease liability relating to the head lease in its statement of financial position, which represents the lease payments owed to the head lessor.~~

~~During the term of the sublease, the intermediate lessor recognizes both finance income on the sublease and interest expense on the head lease.~~

**Example 2122—Sublease classified as an operating lease**

*Head lease—An intermediate lessor enters into a five-year lease for 5,000 square metres of office space (the head lease) with Entity A (the head lessor).*

*Sublease—At commencement of the head lease, the intermediate lessor subleases the 5,000 square metres of office space for two years to a sublessee.*

~~The intermediate lessor classifies the sublease by reference to the right-of-use asset arising from the head lease. The intermediate lessor classifies the sublease as an operating lease, having considered the requirements in paragraphs 61–66 of IFRS 16.~~

When the intermediate lessor enters into the sublease, the intermediate lessor retains the lease liability and the right-of-use asset relating to the head lease in its statement of financial position.

During the term of the sublease, the intermediate lessor:

- (a) Recognizes a depreciation charge for the right-of-use asset and interest on the lease liability; and
- (b) Recognizes lease ~~income~~ revenue and finance revenue from the sublease.

### **Lessee Disclosure (see paragraphs 59 and B49–B50)**

IE10. Example 2223 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B49 of IFRS 16 about variable lease payments. This example shows only current period information. IAS 1 *Presentation of Financial Statements* requires an entity to present comparative information.

#### *Example 2223—Variable Payment Terms*

*Lessee with a high volume of leases with some consistent payment terms*

*Example 22A23A: a retailer (Lessee) operates a number of different branded retail stores—A, B, C and D. Lessee has a high volume of property leases. Lessee’s group policy is to negotiate variable payment terms for newly established stores. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the proportion of total lease payments that arise from variable payments, and the sensitivity of those variable lease payments to changes in sales, is the information that is relevant to users of its financial statements. This information is similar to that reported to Lessee’s senior management about variable lease payments.*

Some of the property leases within the group contain variable payment terms that are linked to sales generated from the store. Variable payment terms are used, when possible, in newly established stores in order to link rental payments to store cash flows and minimize fixed costs. Fixed and variable rental payments by store brand for the period ended 31 December 20X0 are summarized below.

	Stores	Fixed payments	Variable payments	Total payments	Estimated annual impact on total brand rent of a 1% increase in sales
	No.	CU	CU	CU	%
Brand A	4,522	3,854	120	3,974	0.03%
Brand B	965	865	105	970	0.11%

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Brand C	124	26	163	189	0.86%
Brand D	652	152	444	596	0.74%
	<b>6,263</b>	<b>4,897</b>	<b>832</b>	<b>5,729</b>	<b>0.15%</b>

Refer to the management commentary for store information presented on a like-for-like basis and to Note X for segmental information applying ~~IFRS 8 Operating Segments~~ IPSAS 18, Segment Reporting relating to Brands A–D.

*Example 22B23B: a retailer (Lessee) has a high volume of property leases of retail stores. Many of these leases contain variable payment terms linked to sales from the store. Lessee's group policy sets out the circumstances in which variable payment terms are used and all lease negotiations must be approved centrally. Lease payments are monitored centrally. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about the different types of contractual terms it uses with respect to variable lease payments, the effect of those terms on its financial performance and the sensitivity of variable lease payments to changes in sales is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about variable lease payments.*

Many of the property leases within the group contain variable payment terms that are linked to the volume of sales made from leased stores. These terms are used, when possible, in order to match lease payments with stores generating higher cash flows. For individual stores, up to 100 per cent of lease payments are on the basis of variable payment terms and there is a wide range of sales percentages applied. In some cases, variable payment terms also contain minimum annual payments and caps.

Lease payments and terms for the period ended 31 December 20X0 are summarized below.

	Stores	Fixed payments	Variable payments	Total payments
	No.	CU	CU	CU
Fixed rent only	1,490	1,153	-	1,153
Variable rent with no minimum	986	-	562	562
Variable rent with minimum	3,089	1,091	1,435	2,526
	<b>5,565</b>	<b>2,244</b>	<b>1,997</b>	<b>4,241</b>

A 1 per cent increase in sales across all stores in the group would be expected to increase total lease payments by approximately 0.6–0.7 per cent. A 5 per cent increase in sales across all stores in the group would be expected to increase total lease payments by approximately 2.6–2.8 per cent.

*Lessee with a high volume of leases with a wide range of different payment terms*

*Example 22C23C: a retailer (Lessee) has a high volume of property leases of retail stores. These leases contain a wide range of different variable payment terms. Lease terms are negotiated and*

*monitored by local management. Lessee concludes that information about variable lease payments is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee concludes that information about how its property lease portfolio is managed is the information that is relevant to users of its financial statements. Lessee also concludes that information about the expected level of variable lease payments in the coming year (similar to that reported internally to senior management) is also relevant to users of its financial statements.*

Many of the property leases within the group contain variable payment terms. Local management are responsible for store margins. Accordingly, lease terms are negotiated by local management and contain a wide range of payment terms. Variable payment terms are used for a variety of reasons, including minimizing the fixed cost base for newly established stores or for reasons of margin control and operational flexibility. Variable lease payment terms vary widely across the group:

- (a) The majority of variable payment terms are based on a range of percentages of store sales;
- (b) Lease payments based on variable terms range from 0–20 per cent of total lease payments on an individual property; and
- (c) Some variable payment terms include minimum or cap clauses.

The overall financial effect of using variable payment terms is that higher rental costs are incurred by stores with higher sales. This facilitates the management of margins across the group.

Variable rent expenses are expected to continue to represent a similar proportion of store sales in future years.

- IE11. Example 23 illustrates how a lessee with different types of lease portfolios might comply with the disclosure requirements described in paragraphs 59 and B50 of IFRS 16 [draft] IPSAS [X] (ED [X]) about extension options and termination options. This example shows only current period information. ~~IAS 1~~ IPSAS 1 requires an entity to present comparative information.

*Example 2324—Extension Options and Termination Options*

*Lessee with a high volume of leases, that have a wide range of different terms and conditions, which are not managed centrally*

*Example 23A24A: Lessee has a high volume of equipment leases with a wide range of different terms and conditions. Lease terms are negotiated and monitored by local management. Lessee concludes that information about how it manages the use of termination and extension options is the information that is relevant to users of its financial statements and is not available elsewhere in its financial statements. Lessee also concludes that information about (a) the financial effect of reassessing options and (b) the proportion of its short-term lease portfolio resulting from leases with annual break clauses is also relevant to users of its financial statements.*

Extension and termination options are included in a number of equipment leases across the group. Local teams are responsible for managing their leases and, accordingly, lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Extension and termination options are included, when possible, to provide local management with greater flexibility to align its need for access to equipment with the fulfilment of customer contracts. The individual terms and conditions used vary across the group.



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The majority of extension and termination options held are exercisable only by Lessee and not by the respective lessors. In cases in which Lessee is not reasonably certain to use an optional extended lease term, payments associated with the optional period are not included within lease liabilities.

During 20X0, the financial effect of revising lease terms to reflect the effect of exercising extension and termination options was an increase in recognized lease liabilities of CU489.

In addition, Lessee has a number of lease arrangements containing annual break clauses at no penalty. These leases are classified as short-term leases and are not included within lease liabilities. The short-term lease expense of CU30 recognized during 20X0 included CU27 relating to leases with an annual break clause.

*Lessee with a high volume of leases with some consistent terms and options*

*Example 23B24B: a restaurateur (Lessee) has a high volume of property leases containing penalty-free termination options that are exercisable at the option of Lessee. Lessee's group policy is to have termination options in leases of more than five years, whenever possible. Lessee has a central property team that negotiates leases. Lessee concludes that information about termination options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that information about (a) the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) the proportion of termination options that have been exercised historically is the information that is relevant to users of its financial statements. Lessee also notes that presenting this information on the basis of the same restaurant brands for which segment information is disclosed applying IFRS 8 IPSAS 18 is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about termination options.*

Many of the property leases across the group contain termination options. These options are used to limit the period to which the group is committed to individual lease contracts and to maximize operational flexibility in terms of opening and closing individual restaurants. For most leases of restaurants, recognized lease liabilities do not include potential future rental payments after the exercise date of termination options because Lessee is not reasonably certain to extend the lease beyond that date. This is the case for most leases for which a longer lease period can be enforced only by Lessee and not by the landlord, and for which there is no penalty associated with the option.

Potential future rental payments relating to periods following the exercise date of termination options are summarized below.

Business Segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (undiscounted)		
		Payable during 20X1–20X5	Payable during 20X6–20Y0	Total
	CU	CU	CU	CU
Brand A	569	71	94	165
Brand B	2,455	968	594	1,562

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Brand C	269	99	55	154
Brand D	1,002	230	180	410
Brand E	914	181	321	502
	<b>5,209</b>	<b>1,549</b>	<b>1,244</b>	<b>2,793</b>

The table below summarizes the rate of exercise of termination options during 20X0.

Business segment	Termination option exercisable during 20X0	Termination option not exercised	Termination option exercised
	No. of leases	No. of leases	No. of leases
Brand A	33	30	3
Brand B	86	69	17
Brand C	19	18	1
Brand D	30	5	25
Brand E	66	40	26
	<b>234</b>	<b>162</b>	<b>72</b>

*Example 23G24C: Lessee has a high volume of large equipment leases containing extension options that are exercisable by Lessee during the lease. Lessee's group policy is to use extension options to align, when possible, committed lease terms for large equipment with the initial contractual term of associated customer contracts, whilst retaining flexibility to manage its large equipment and reallocate assets across contracts. Lessee concludes that information about extension options is relevant to users of its financial statements and is not available elsewhere in its financial statements. In particular, Lessee concludes that (a) information about the potential exposure to future lease payments that are not included in the measurement of lease liabilities and (b) information about the historical rate of exercise of extension options is the information that is relevant to users of its financial statements. This is similar to the information that is reported to Lessee's senior management about extension options.*

Many of the large equipment leases across the group contain extension options. These terms are used to maximize operational flexibility in terms of managing contracts. These terms are not reflected in measuring lease liabilities in many cases because the options are not reasonably certain to be exercised. This is generally the case when the underlying large equipment has not been allocated for use on a particular customer contract after the exercise date of an extension option. The table below summarizes potential future rental payments relating to periods following the exercise dates of extension options.

Business segment	Lease liabilities recognised (discounted)	Potential future lease payments not included in lease liabilities (discounted)	Historical rate of exercise of extension options
	CU	CU	%

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Segment A	569	799	52%
Segment B	2,455	269	69%
Segment C	269	99	75%
Segment D	1,002	111	41%
Segment E	914	312	76%
	<b>5,209</b>	<b>1,590</b>	<b>67%</b>

**Sale and Leaseback Transactions (see paragraphs 87–92)**

IE12. Example ~~2425~~ illustrates the application of the requirements in paragraphs 88–91 of ~~IFRS 16~~ [draft] IPSAS [X] (ED [X]) for a seller-lessee and a buyer-lessor.

*Example ~~2425~~—Sale and Leaseback Transaction*

*An entity (Seller-lessee) sells a building to another entity (Buyer-lessor) for cash of CU2,000,000. Immediately before the transaction, the building is carried at a cost of CU1,000,000. At the same time, Seller-lessee enters into a contract with Buyer-lessor for the right to use the building for 18 years, with annual payments of CU120,000 payable at the end of each year. The terms and conditions of the transaction are such that the transfer of the building by Seller-lessee satisfies the requirements ~~for determining when a performance obligation is satisfied in IFRS 15 Revenue from Contracts with Customers~~ of IPSAS 9, Revenue from Exchange Transactions. Accordingly, Seller-lessee and Buyer-lessor account for the transaction as a sale and leaseback. This example ignores any initial direct costs.*

*The fair value of the building at the date of sale is CU1,800,000. Because the consideration for the sale of the building is not at fair value, Seller-lessee and Buyer-lessor make adjustments to measure the sale proceeds at fair value. The amount of the excess sale price of CU200,000 (CU2,000,000 – CU1,800,000) is recognized as additional financing provided by Buyer-lessor to Seller-lessee.*

*The interest rate implicit in the lease is 4.5 per cent per annum, which is readily determinable by Seller-lessee. The present value of the annual payments (18 payments of CU120,000, discounted at 4.5 per cent per annum) amounts to CU1,459,200, of which CU200,000 relates to the additional financing and CU1,259,200 relates to the lease—corresponding to 18 annual payments of CU16,447 and CU103,553, respectively.*

~~*Buyer-lessor classifies the lease of the building as an operating lease.*~~

**Seller-lessee**

At the commencement date, Seller-lessee measures the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right of use retained by Seller-lessee, which is CU699,555. This is calculated as: CU1,000,000 (the carrying amount of the building) ÷ CU1,800,000 (the fair value of the building) × CU1,259,200 (the discounted lease payments for the 18-year right-of-use asset).

## [DRAFT] IPSAS [X] (ED [X])—LEASES

Seller-lessee recognizes only the amount of the gain that relates to the rights transferred to Buyer-lessor of CU240,355 calculated as follows. The gain on sale of building amounts to CU800,000 (CU1,800,000 – CU1,000,000), of which:

- (a) CU559,645 ( $\text{CU800,000} \div \text{CU1,800,000} \times \text{CU1,259,200}$ ) relates to the right to use the building retained by Seller-lessee; and
- (b) CU240,355 ( $\text{CU800,000} \div \text{CU1,800,000} \times (\text{CU1,800,000} - \text{CU1,259,200})$ ) relates to the rights transferred to Buyer-lessor.

At the commencement date, Seller-lessee accounts for the transaction as follows.

Cash	CU2,000,000	
Right-of-use asset	CU699,555	
Building		CU1,000,000
Financial liability		CU1,459,200
Gain on rights transferred		CU240,355

Buyer-lessor

At the commencement date, Buyer-lessor accounts for the transaction as follows.

Building	CU1,800,000	
Financial asset	CU200,000 (18 payments of CU16,447, discounted at 4.5 per cent per annum)	
Cash		CU2,000,000

After the commencement date, Buyer-lessor accounts for the lease by treating CU103,553 of the annual payments of CU120,000 as lease payments. The remaining CU16,447 of annual payments received from Seller-lessee are accounted for as (a) payments received to settle the financial asset of CU200,000 and (b) interest revenue.

### **Comparison with IFRS 16**

[draft] IPSAS [X] (ED[X]), *Leases* is drawn primarily from IFRS 16 (2016), *Leases*.

The main differences between [draft] IPSAS [X] (ED[X]) and IFRS 16 are as follows:

- [draft] IPSAS [X] (ED[X]) applies to concessionary leases, i.e., leases that are not exchange transactions. IFRS 16 only applies to leases that are exchange transactions.
- [draft] IPSAS [X] (ED[X]) clarifies the accounting treatment of budget funding or cancellation clauses that are normally used in the public sector for budgetary reasons. IFRS 16 does not provide such guidance.
- [draft] IPSAS [X] (ED[X]) uses different terminology from IFRS 16. For example, [draft] IPSAS [X] (ED[X]) uses the terms “revenue”, “operation” and “segment”, while IFRS 16 uses the terms “income”, “business unit” and “business segment”.
- [draft] IPSAS [X] (ED[X]) uses the right-of-use model in lessor accounting. IFRS 16 retains the risks and rewards incidental to ownership model in lessor accounting that existed in IAS 17, *Leases*.
- [To be added at the September 2017 meeting]

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