

Agenda Item 14: Leases

João Fonseca, Principal

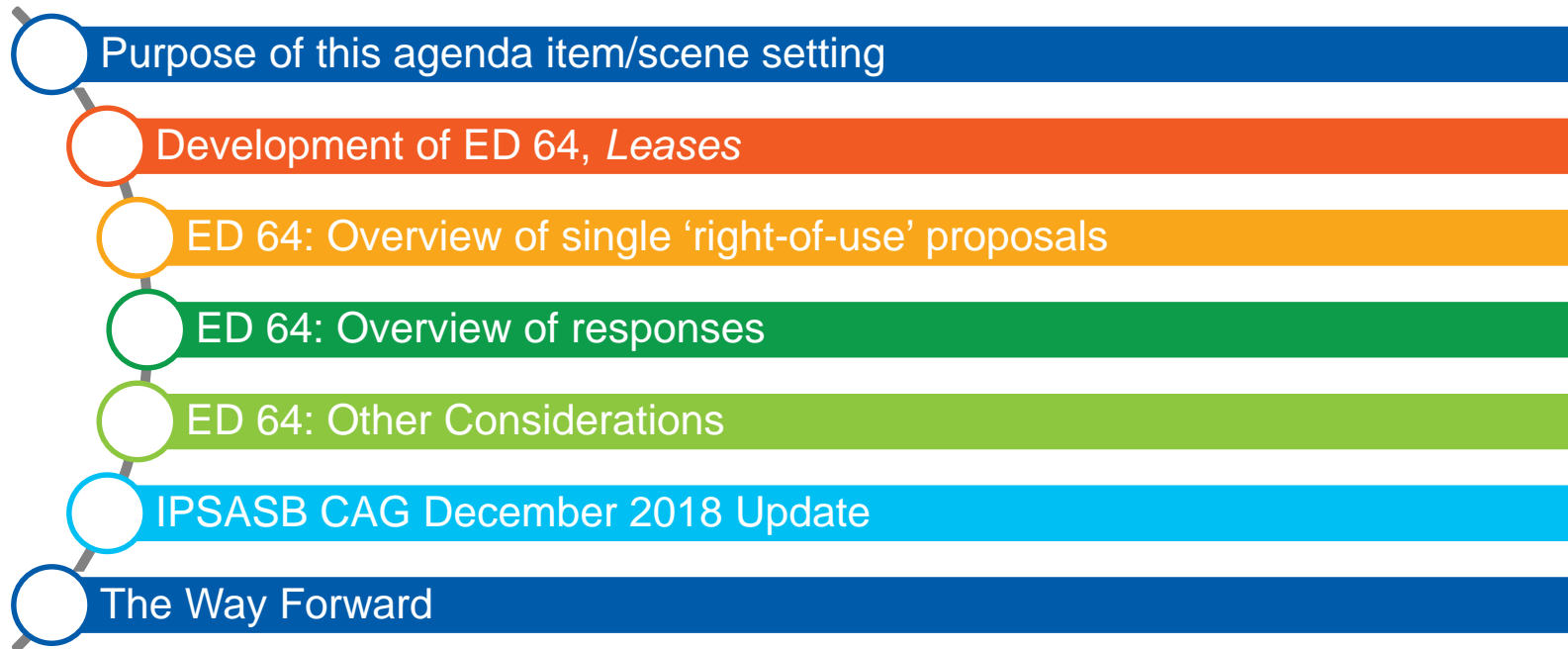
Mike Blake, Task Force Chair

IPSASB Meeting

Washington D.C., USA

March 12–15, 2019

Outline



Purpose of this agenda item/scene setting

- Focus is on lessor accounting
- Proposals in ED 64 not universally supported
- Strong counter arguments made by some jurisdictions
- Factors raised are complex
- Departure from IFRS warrants further consideration in particular any implications for mixed groups and consolidations
- Developments since December 2018 meeting

Purpose of this agenda item/scene setting

- **IPSASB will be asked to:**

- Revisit the decisions made to date
- Agreement on the process to be followed between now and the June meeting and instruct the Task Force (TF) accordingly (to be referred to as phase 1):
 1. Examine all responses focusing on reasons for departing, or not departing, from IFRS 16
 2. Subject to conclusions on 1, evaluate implications and make recommendations to IPSASB in June 2019
 3. IPSASB to consider/redeliberate departure decision in June 2019
 4. Outcome of 3 will determine next steps post June 2019 meeting, including TF remit
- Phase 2 will depend on the discussions at the June 2019 meeting

Purpose of this agenda item/scene setting

- **Focus of remainder of this session:**
 - Compliance with Rules of the Road
 - Reminder on elements of ED 64 as this relates to lessor accounting
 - High level summary of responses to ED 64 noting stakeholder views about:
 - ED 64's proposals for departure from IFRS 16
 - Specific areas where some stakeholders did not support arguments for lessor accounting in ED 64
 - Other considerations - factors raised perhaps not previously considered
 - Other considerations - cross reference to aspects of the Conceptual Framework
 - CAG considerations

Purpose of this agenda item/scene setting

- **What we will not do today**
 - Revisit decision making by the IASB in determining IFRS 16
 - Further explore accounting for concessionary leases by either the lessee or lessor for the time being

Purpose of this agenda item/scene setting

- **IPSASB December 2018 meeting**
 - Confirmed tentative decision made in September to adopt the lessee accounting requirements in ED 64, subject to decisions on the approach to be taken to lessor accounting, and where relevant, concessionary leases;
 - Not to publish lessee accounting requirements in ED 64 ahead of the decisions on lessor accounting, and where relevant, concessionary leases; and
 - To create a TF to consider all the issues raised by respondents;
- **However, there is a need to reflect**

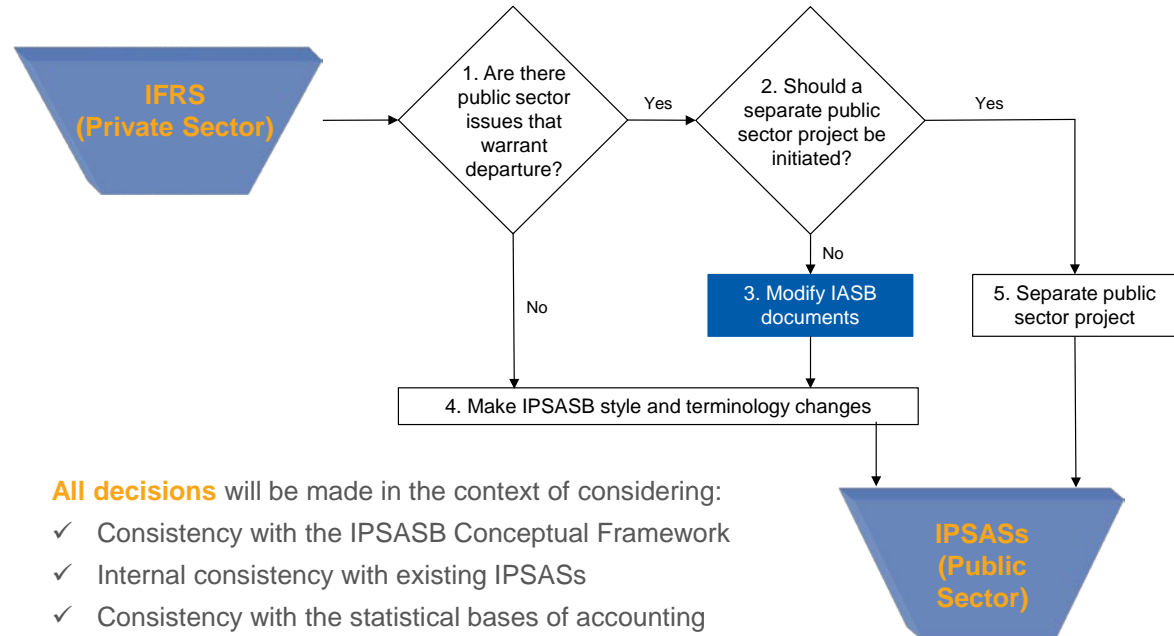
Purpose of this agenda item/scene setting

- **Instructions we seek from this IPSASB meeting**
 - IPSASB input as the presentation progresses;
 - Confirmation of the proposed way forward outlined in the slide 25

Development of ED 64, *Leases*



‘Rules of the Road’



All decisions will be made in the context of considering:

- ✓ Consistency with the IPSASB Conceptual Framework
- ✓ Internal consistency with existing IPSASs
- ✓ Consistency with the statistical bases of accounting

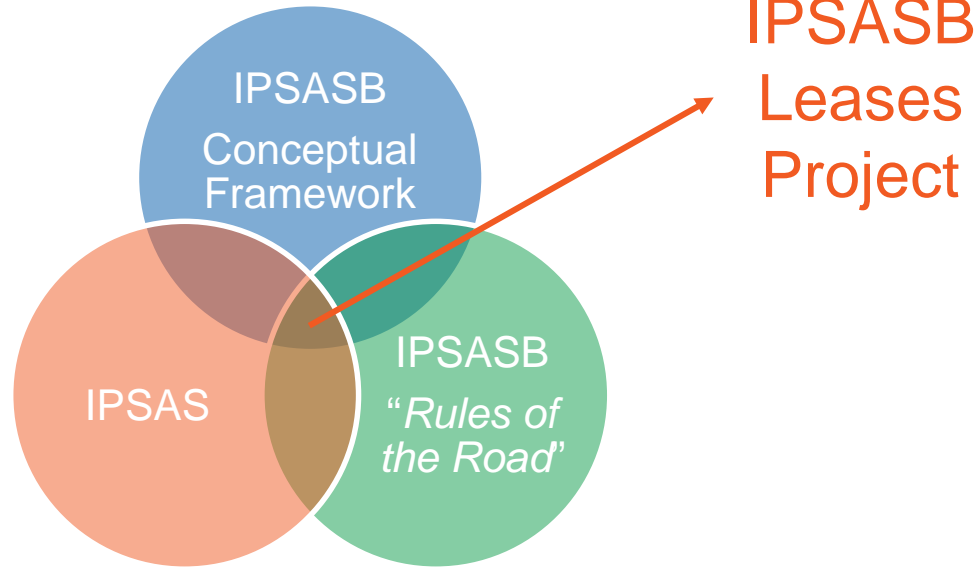
Development of ED 64, *Leases*

- **Items that might affect IPSASB's considerations:**
 - Existence of sovereign powers;
 - Existence of contributed/donated assets or non-exchange activities;
 - Existence of non-cash-generating activities or assets;
 - Impact of social benefits;
 - Accountability/stewardship differences;
 - Governance or management of structural differences;
 - Sustainability issues; and
 - Differences related to structure or service potential of assets.



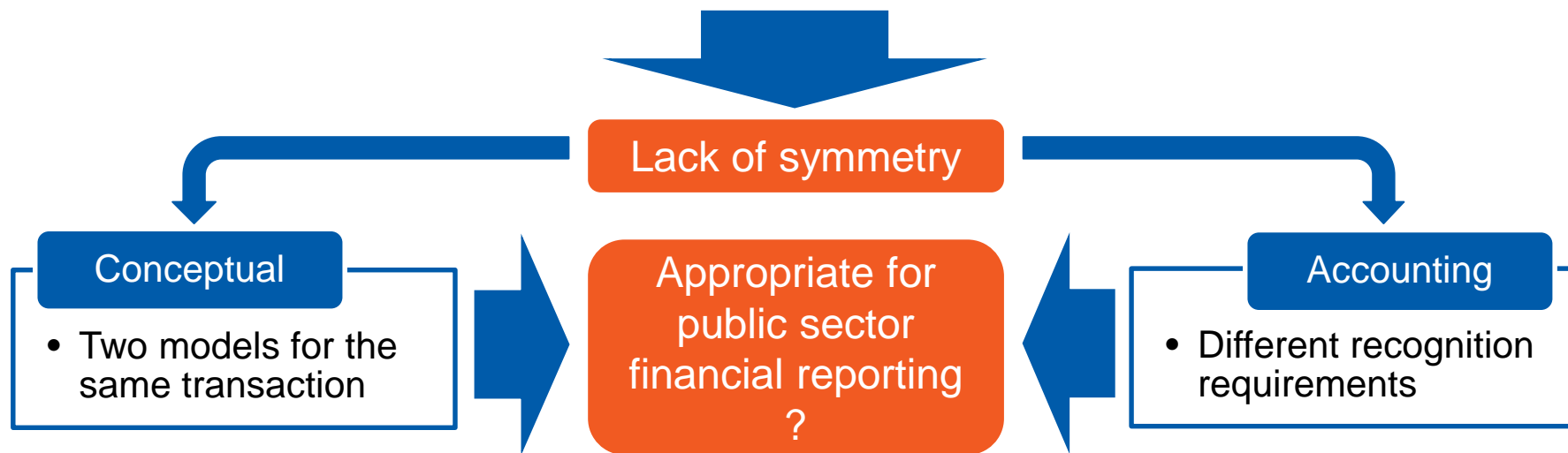
Development of ED 64, *Leases*

- Influences on IPSASB Leases Project**



Development of ED 64, *Leases*

- Retention of IAS 17 risks and rewards model in IFRS 16 for lessors



Development of ED 64, *Leases*

- Retention of IAS 17 risks and rewards model in IFRS 16 for lessors

Lessor and lessee are public sector entities

Lessor's lease classification

Finance Lease

- The underlying asset is **neither recognized** by the lessor nor by the lessee because the lessee recognizes a right-of-use asset not the underlying asset

Operating Lease

- The lessor **does not recognize** a lease receivable, while the lessee **always recognizes** a lease liability

Development of ED 64, *Leases*

Risks and rewards model for lessor accounting in IFRS 16

- Is inconsistent with the *Conceptual Framework*
- Does not distinguish the right-of-use asset from the underlying asset
- Does not recognize the lease receivable in an operating lease
- Derecognizes the underlying asset in a finance lease, although the lessor **still controls it**
- Does not satisfy the objectives of public sector financial reporting
- Is inconsistent with IPSAS 32, *Service Concession Arrangements: Grantor*
- Creates consolidation issues where the lessor and the lessee are part of the same economic entity
- Creates understandability issues to distinguish a sale from a lease
- Creates asymmetrical information in the public sector



Not appropriate for public sector financial reporting

ED 64: Overview of single 'right-of-use' proposals



Accounting for the underlying asset

- **Lessor** recognizes and measures according to the applicable IPSAS
 - different to IFRS 16

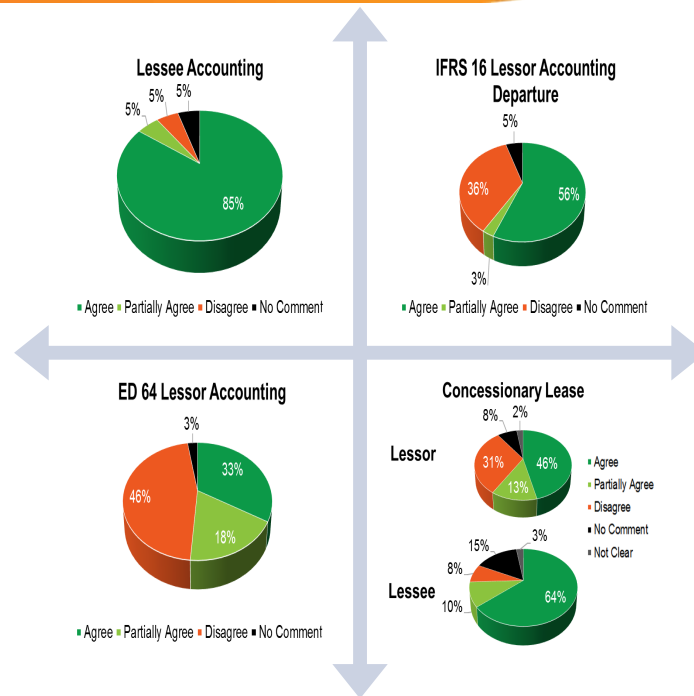


Separate accounting for the lease (right-of-use)

- **Lessee liability** – as per IFRS 16
- **Lessor receivable** – different to IFRS 16
- **Lessor liability (unearned revenue)** – different to IFRS 16
- At market terms – unless a concessionary lease
- At below market terms – concessionary leases

ED 64: Overview of responses

- **Lessee accounting:**
 - Strong support for ‘right of use’ approach
- **Lessor accounting:**
 - Majority support for IFRS 16 departure
 - Lack of clear support for ED 64 proposals
 - Alternative proposals
 - Opposing views on the same issues
- **Concessionary leases:**
 - Majority support for lessee proposals
 - Diverse views on lessor proposals

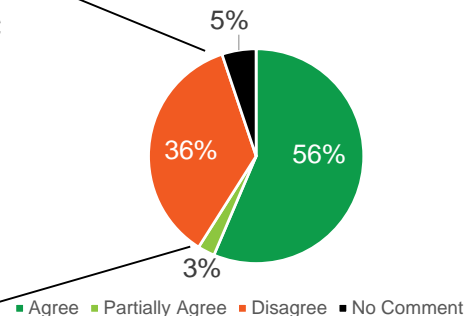


ED 64: Overview of responses

• Some key areas where some respondents did not support ED 64

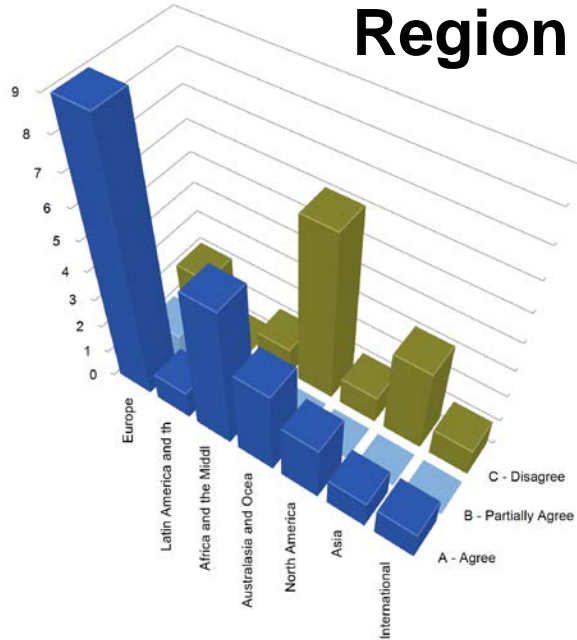
- Rationale for departure not strong enough (R04, R12, R25, R27, R28)
- Reasons to depart from IFRS 16 are not more prevalent in the public sector or different from the private sector (R04, R11, R12, R27, R33)
- Consolidation under ED 64 more difficult for public sector entities that apply IFRS (mixed groups) (R10, R12, R16, R25, R27)
- User information needs in the public sector do not significantly differ from those in the private sector (R10, R36)

IFRS 16 Lessor Accounting Departure



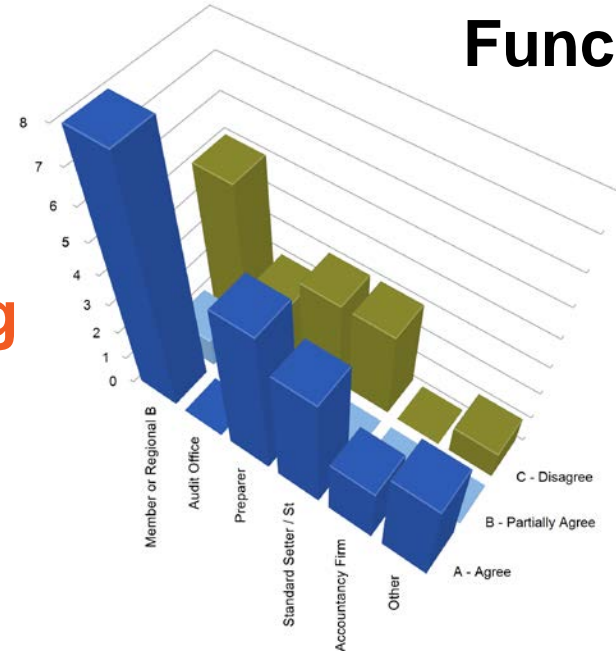
ED 64: Overview of responses

Region



IFRS 16 Lessor Accounting Departure

Function

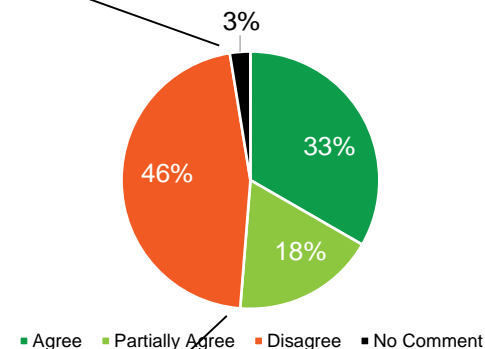


ED 64: Overview of responses

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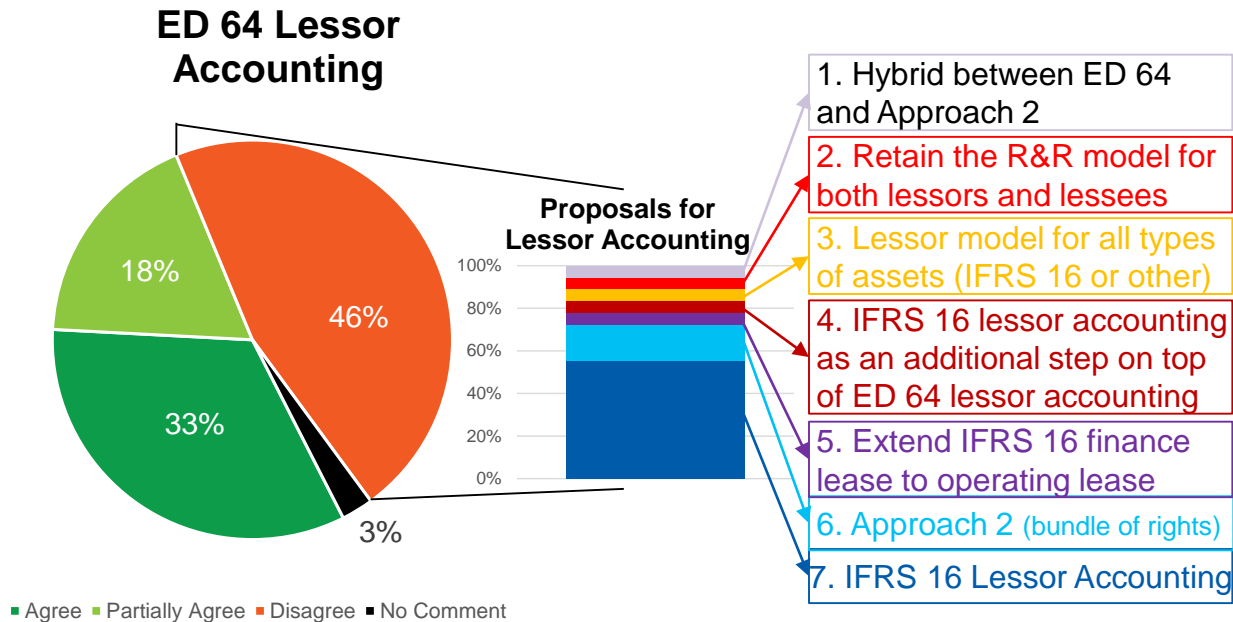
- There is double-counting of the underlying asset and the lease receivable (R04, R10, R11, R12, R16, R19, R23, R25, R27, R28, R29)
- The liability (unearned revenue) does not meet the definition of a liability (R10, R11, R16, R25, R27, R29)
- Inconsistent with the Conceptual Framework (R07, R25, R27, R36)
- Not comparable with IPSAS 32 (R04, R25, R27)
- The lease receivable is not a financial asset (R29, R31)
- Lessor transfers control (R07) of the resource and should derecognize the underlying asset in a finance lease (R10, R11, R28, R29, R33)

ED 64 Lessor Accounting



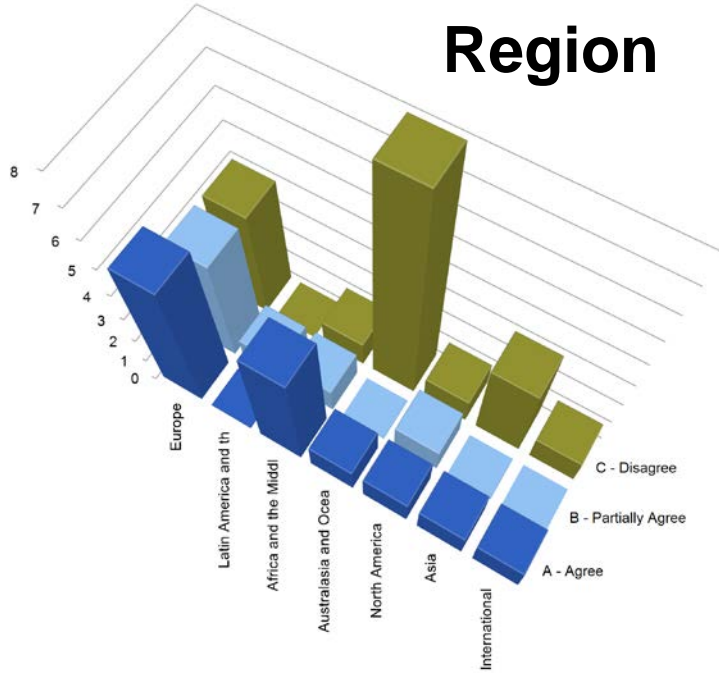
ED 64: Overview of responses

“Lessor Accounting: A World Divided”



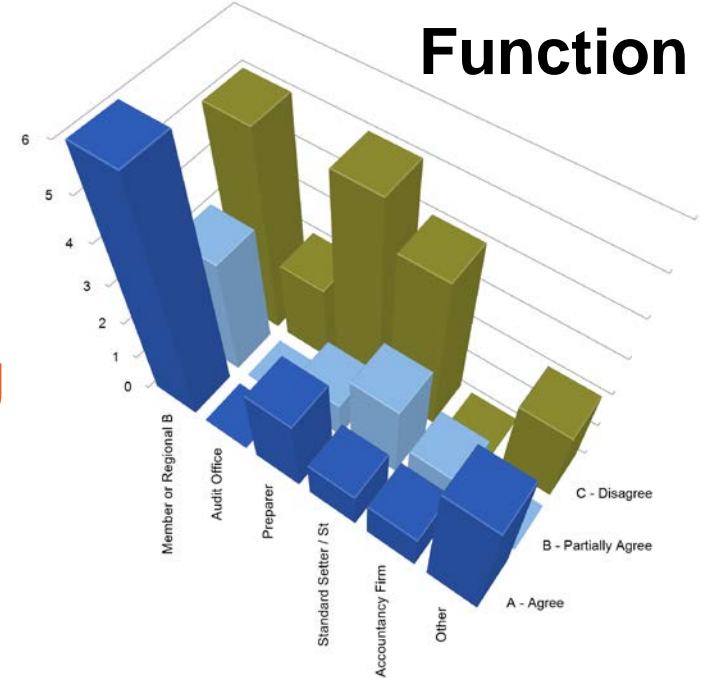
ED 64: Overview of responses

Region



ED 64 Lessor Accounting

Function



ED 64: Other considerations

• Further considerations on IPSASB Conceptual Framework

Financial Reporting Objectives

- Accountability:
'...information about the entity's management of resources entrusted to it for the delivery of services to constituents and others, and its compliance with legislation, regulation or other authority that governs and other operations.'
- Decision making

Qualitative Characteristics

- Relevance
- Faithful representation
- Understandability
- Timeliness
- Comparability
- Verifiability

Pervasive constraints:

- Materiality
- Cost benefit

ED 64: Other considerations

- **Other matters identified from review of responses:**

- Do ED 64 proposals fairly reflect the rights and obligations of the lessor or the economic substance of the transaction?
- Has the IPSASB considered possible unintended consequences of ED 64 proposals?
- Is the arrangement in fact a lease, or simply providing a third party with rights of access to an asset?
- Should a standard on leases more deliberately define what is, and what is not, a lease in a public sector context?

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IPSASB CAG December 2018 Meeting Update



New Strategy to Move the Leases Project Forward


Double-counting in ED 64 lessor accounting?

Recognize the subsidy in a concessionary lease?

The Way Forward

- **Criteria to Assess Departure or Not from IFRS 16 Lessee Accounting (December 2018 meeting)**

1. Consistency with Conceptual Framework (Rules of the Road)
2. Consistency with IPSAS (Rules of the Road)
3. IFRS Alignment
4. Implementation Issues
5. User's needs of financial community
6. Relationship with GFS
7. Relationship with public-private partnerships



**Valid to assess
departure or not
from IFRS 16
Lessor
Accounting?**

The Way Forward

- **Confirmation from the IPSASB that we proceed with phase 1:**
 1. A TF to be established
 2. It will examine all responses focusing on reasons for departing, or not departing, from IFRS 16
 3. Subject to conclusions on 1, TF to evaluate implications based on agreed criteria and make recommendations to IPSASB in June 2019
 4. IPSASB to consider/redeliberate departure decision in June 2019
 5. Outcome of 4 will determine next steps post June 2019 meeting, including TF remit
 6. Accounting for concessionary leases to be addressed once step 5 completed



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