Agenda Item 7: Leases

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Manager, Standards Development and Technical Projects

IPSASB Meeting
Washington, D.C., USA
March 7-10, 2017
Objective of Session & Material Presented

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

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

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

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

(see Appendix A of Agenda Item 7.2.3 for details)
Two issues:

- Draft text to be included in the core Standard and in the Basis for Conclusions
- IFRS 16 consequential amendments to IFRS 15, *Revenue from Contracts with Customers*
Leases
Sale and leaseback transactions (Agenda Item 7.2.4)

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

(see Appendix A of Agenda Item 7.2.4 for details)
Sale and leaseback transactions (Agenda Item 7.2.4)

• Matter for consideration

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

Sale and leaseback transactions
(Agenda Item 7.2.4)

• IFRS 16 consequential amendments to IFRS 15, *Revenue from Contracts with Customers*:
  – IFRS 16 includes several consequential amendments to the Application Guidance of IFRS 15 in the repurchase agreements section (IFRS 15.B64-B76);
  – The IPSASB does not an equivalent to IFRS 15;
  – Two options to deal with the consequential amendments to IFRS 15 in IFRS 16
• Two options to deal with the consequential amendments to IFRS 15 in IFRS 16
  – **Option 1**– Do not include the IFRS 15 guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9, and include the guidance later in the new or revised IPSAS on Revenue; and
  – **Options 2**– Include the IFRS 15 guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9.
Two options to deal with the consequential amendments to IFRS 15 in IFRS 16

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Option 1</th>
<th>Option 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantages</td>
<td>• Maintains the current situation in IPSAS 9 based on risks and rewards.</td>
<td>• Ensures a consistent treatment of sale and leaseback in the context of repurchase agreements.</td>
</tr>
<tr>
<td>Disadvantages</td>
<td>• No consistency with IFRS 15 and IFRS 16.</td>
<td>• Creates an internal conceptual inconsistency in IPSAS 9 (control versus risks and rewards).</td>
</tr>
</tbody>
</table>
Two options to deal with the consequential amendments to IFRS 15 in IFRS 16

Staff’s recommendation

- **Option 1** because the internal conceptual inconsistency that Option 2 implies can have unpredictable harmful consequences in the applicability of IPSAS 9.
Two options to deal with the consequential amendments to IFRS 15 in IFRS 16

Matter for consideration

- Does the IPSASB support:
  - Option 1 (do not include the repurchase agreements section in IFRS 15, which includes the sale and leaseback guidance) in IPSAS 9; or
  - Option 2 (include the IFRS 15 guidance on repurchase agreements, which includes the guidance on sale and leaseback) in IPSAS 9?
**Decisions** from IPSASB December 2016 meeting

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

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

<table>
<thead>
<tr>
<th></th>
<th><strong>Approach 1</strong></th>
<th><strong>Approach 2</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Underlying asset</td>
<td>Continues to recognize the underlying asset <em>in its entirety</em></td>
<td>Derecognizes portions of rights of the underlying asset transferred to the lessee</td>
</tr>
<tr>
<td>Credit entry</td>
<td>Recognized in the statement of financial position and reduced subsequently over the lease term as revenue is recognized in the statement of financial performance</td>
<td>Recognized immediately in the statement of financial performance</td>
</tr>
</tbody>
</table>

*Not a sale of assets*  

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

- **Methodology** – Boundaries

![Venn Diagram]

- IPSASB Conceptual Framework
- IPSAS 32
- IPSASB “Rules of the Road”
- IPSASB Leases Project
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

• **Methodology** – Criteria of Analysis for Lessor Accounting
  
  - Consistency with IPSASB’s literature
  - Consistency with right-of-use model for lessee accounting
  - Consequential amendments to other IPSASs
  - Public sector specific issues
  - Public interest considerations on Approaches 1 and 2
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

Recognition and derecognition of the underlying asset - entirety versus portions

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Approach 1</th>
<th>Approach 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>IPSAS 16 and IPSAS 17</td>
<td>Consistent</td>
<td>Not consistent</td>
</tr>
<tr>
<td>Sale and leaseback</td>
<td>Consistent</td>
<td>Not consistent</td>
</tr>
<tr>
<td>IPSAS 32</td>
<td>Consistent</td>
<td>Not consistent</td>
</tr>
<tr>
<td>Conceptual Framework</td>
<td>Consistent</td>
<td>Not consistent</td>
</tr>
<tr>
<td>Joint Control (IPSAS 37)</td>
<td></td>
<td>Not applicable to leases</td>
</tr>
</tbody>
</table>
### Recognition and derecognition of the underlying asset - entirety versus portions

#### II – Consistency with right-of-use model for lessee accounting

<table>
<thead>
<tr>
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<th>Approach 2</th>
</tr>
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</table>
| Underlying asset  | Consistent at type of asset level (the lessee controls the intangible right-of-use asset, and the lessor controls the physical asset) | • Inconsistent at type of asset level (the lessee controls the intangible right-of-use asset, and the lessor controls the intangible right to receive back the underlying asset).  
• Neither the lessee nor the lessor recognize the physical asset. |
Leases

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

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

Recognition and derecognition of the underlying asset - entirety versus portions

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>III – Consequential amendments to other IPSASs</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• IPSAS 16 – Exclude the lease receivable in subsequent measurement</td>
<td>• Amend the principles in IPSAS 16, IPSAS 17, and IPSAS 32; or</td>
</tr>
<tr>
<td></td>
<td>• IPSAS 32 – Term “liability” needs to be amended</td>
<td>• New IPSAS with different guidance from IPSAS 16, IPSAS 17 and IPSAS 32</td>
</tr>
</tbody>
</table>
Leases

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

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

Recognition and derecognition of the underlying asset - entirety versus portions

<table>
<thead>
<tr>
<th>Criteria</th>
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</tr>
</thead>
<tbody>
<tr>
<td>IV – Public sector specific issues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountability</td>
<td>Focus on physical asset in its entirety</td>
<td>Focus on individual rights (bundle of rights) over physical assets</td>
</tr>
<tr>
<td>Decision-making</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountability</td>
<td></td>
<td></td>
</tr>
<tr>
<td>V – Public Interest Considerations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Physical asset is always recognized in the financial statements of lessor.</td>
<td>Physical asset is not recognized in the financial statements of lessee and lessor.</td>
<td></td>
</tr>
</tbody>
</table>
Leases

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

- **Methodology** – Criteria of Analysis – Main Conclusions
  
  Recognition and derecognition of the underlying asset - entirety versus portions

  - **Approach 1:**
    - Does not break the principles in IPSAS 16, IPSAS 17 and IPSAS 32
    - Is consistent with a control-based approach to recognize assets

  - **Approach 2:**
    - Conflicts with the principles in IPSAS 16, IPSAS 17 and IPSAS 32
    - Is inconsistent with a control-based approach to recognize assets
Matter for consideration

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

(a) Approach 1 to lessor accounting (continuing to recognize the underlying asset in its entirety)?

(b) Approach 2 to lessor accounting (derecognizing portions (“slices”) of the underlying asset transferred to the lessee)?

(c) Inclusion of an Alternative View supporting the approach that is not proposed in the Exposure Draft?
Leases

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

• **Methodology** – Criteria of Analysis
  
  Recognition of credit entry – Conceptual Framework

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

  **Approach 2** – In the statement of financial performance
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

Recognition of credit entry

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Approach 1</th>
<th>Approach 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>I – Consistency with IPSASB’s existing literature</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IPSAS 32</td>
<td>Consistent</td>
<td>Not consistent</td>
</tr>
<tr>
<td>Conceptual Framework</td>
<td></td>
<td>Not conclusive</td>
</tr>
</tbody>
</table>
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

  **Three possible ways:**

  a) Liability;

  b) Revenue; and

  c) Other obligation.
Leases

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

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

  Recognition of credit entry – Conceptual Framework

**Liability:**

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

**Revenue:**

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

**Other obligation:**

“Obligation that does not satisfy the definition of an element defined in the Conceptual Framework.”
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

  Recognition of credit entry – Conceptual Framework

**Net financial position:**

“Difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.”
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

  Recognition of credit entry – Conceptual Framework

  **Liability?**

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

  The credit entry (unearned revenue) cannot be presented as a liability in the statement of financial position.
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

**Revenue?**

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

Revenue should not be recognized immediately in the statement of financial performance.
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

**Revenue?**

Task Based Group views:

- Some support for initial recognition of the entire amount at inception of the lease in the statement of financial performance.
- Some support for recognition over the lease term in the statement of financial performance.
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

  Recognition of credit entry – Conceptual Framework

**Revenue?**

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

Revenue may be initially recognized in any financial statement.
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

Revenue?

- Through net assets/equity ➔ Recycling mechanism
- Elsewhere in the statement of financial position ➔ Reduced as revenue is recognized in the statement of financial performance

Revenue

Amend IPSAS 1 and IPSAS 32

Other obligation

- Through net assets/equity ➔ Recycling mechanism
- Elsewhere in the statement of financial position ➔ Reduced as revenue is recognized in the statement of financial performance

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

Methodology – Criteria of Analysis – Main Conclusions

Recognition of credit entry – Conceptual Framework

**Revenue?**

- **Revenue** in the statement of financial position

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

The IPSASB included other obligations and other resources as possible approaches to addressing deferrals in the Conceptual Framework
Leases
Lessor—Analysis of lessor accounting approaches to the right-of-use model (Agenda Item 7.2.1)

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

  Recognition of credit entry – Conceptual Framework

**Revenue?**

**Other obligation** in the statement of financial position → **Inconsistent with definition of revenue** → The IPSASB may conclude that, where there is no matching liability, revenue should be recognized in the statement of financial performance. This could justify the treatment of the credit as an other obligation.
Matter for consideration

Does the IPSASB support to include in the Exposure Draft on Leases:
(a) Approach 1 to lessor accounting (recognize revenue over the lease term in the statement of financial performance)?
(b) Approach 2 to lessor accounting (recognize revenue immediately in the statement of financial performance)?
(c) Inclusion of an Alternative View supporting the approach that is not proposed in the Exposure Draft?
Leases for zero or nominal consideration
(Agenda Item 7.2.2)

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

Leases for zero or nominal consideration (Agenda Item 7.2.2)

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

Leases for zero or nominal consideration (Agenda Item 7.2.2)

• Two types of concessionary leases
  – Leases for zero or nominal consideration; and
  – Leases above zero or nominal consideration, but below fair value.
Leases for zero or nominal consideration
(Agenda Item 7.2.2)

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

(Agenda Item 7.2.2)

- Options for guidance on leases for zero or nominal consideration

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Option 1</th>
<th>Option 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donation in kind vs financing transaction</td>
<td>In the Non-Exchange Expense project and IPSAS 23</td>
<td>In the Leases project</td>
</tr>
<tr>
<td>IFRS 16 definition of a lease</td>
<td>Retained</td>
<td>Remove the wording “in exchange for consideration”</td>
</tr>
</tbody>
</table>
| Concentration vs dispersion of subject in IPSASs | • Include guidance on concessionary leases that are similar to concessionary loans.  
• Amend IPSAS 23 in the same way as for concessionary loans. | • Include guidance on both types of concessionary leases.  
• Amend IPSAS 23 in the same way as for concessionary loans. |
**Options for guidance on leases for zero or nominal consideration**

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Option 1</th>
<th>Option 2</th>
</tr>
</thead>
</table>
| **Advantages** | • Maintains consistency with the IFRS 16 definition of a lease.  
• Increases internal consistency of IPSAS on Leases because includes only transactions that have the same economic nature.  
• Increases consistency with IPSAS 29. | • Preparers will find guidance on all types of “leases” or arrangements with some of the characteristics of a lease as currently defined in a single Standard. |
Leases
Leases for zero or nominal consideration
(Agenda Item 7.2.2)

- Options for guidance on leases for zero or nominal consideration

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Option 1</th>
<th>Option 2</th>
</tr>
</thead>
</table>
| Disadvantages  | • Preparers need to find guidance on leases in different Standards depending on whether there is or not consideration.  
• There will be no guidance on how to account for the subsidized component from the lessor side until the new Standard on Non-Exchange Expense is approved. | • Does not maintain consistency with the IFRS 16 definition of a lease.  
• Lack of consistency in the IPSAS on Leases because includes transactions with different economic natures.  
• Lack of consistency with IPSAS 29. |
Leases for zero or nominal consideration (Agenda Item 7.2.2)

• Matter for consideration

Does the IPSASB support:

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

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