

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Washington D.C., USA

Meeting Date: March 7–10, 2017

From: João Fonseca

Agenda Item 7

For:

☐ Approval

☒ Discussion

☒ Information

LEASES

Project summary	Develop revised requirements for lease accounting covering both lessees and lessors in order to maintain convergence with IFRS 16, <i>Leases</i> , to the extent appropriate. The project will result in a new IPSAS that will replace IPSAS 13, <i>Leases</i> .	
Meeting objectives	Topic	Agenda Item
Project management	Instructions up to December 2016 meeting	7.1.1
	Decisions up to December 2016 meeting	7.1.2
	Project roadmap	7.1.3
Decisions required at this meeting	Lessor—Analysis of lessor accounting approaches to the right-of-use model	7.2.1
	Leases for zero or nominal consideration	7.2.2
	Lessee—Reassessment of the lease liability and lease modifications	7.2.3
	Sale and leaseback transactions	7.2.4

Agenda Item

7.1.1

INSTRUCTIONS UP TO DECEMBER 2016 MEETING

Meeting	Instruction	Actioned
June 2016	<p>The IPSASB directed staff to bring the following issues and items to future meetings:</p> <ul style="list-style-type: none"> • Recognition exemptions and threshold of leases of low-value assets; • Presenting some fact patterns based on several types of “peppercorn leases”; • Explaining in more detail the IFRS 16 lessor accounting model; • 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; • Present a high level history of the IASB’s project to explore why and when IASB modified their proposals for lessor accounting; • Explain how property and vehicle leases are accounted for in existing guidance in IPSAS 13 and in IFRS 16. 	
September 2016	<p>The IPSASB directed staff to:</p> <ul style="list-style-type: none"> • Draft text to be included in the core Standard on guidance about sales that are in the context of a sale and leaseback transaction, and a draft Basis for Conclusions on why the IPSASB took this decision; • 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. 	
December 2016	<p>The IPSASB directed 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>	

Agenda Item

7.1.2

DECISIONS UP TO DECEMBER 2016 MEETING

Date of Decision	Decision
June 2016	<ul style="list-style-type: none"> • To apply the right-of-use model to lessee accounting in the Exposure Draft on Leases; • To include in the Basis for Conclusions in the Exposure Draft on Leases the advantages and disadvantages identified by the IPSASB and the reason for IPSASB's decision on the extent of adoption of the right of use model; • To adopt the IFRS 16 recognition exemptions in the Exposure Draft on Leases; • Recognition exemptions should be an option, rather than a requirement, in the Exposure Draft on Leases;
September 2016	<ul style="list-style-type: none"> • The IPSASB made a tentative decision not to include explicit guidance in an Exposure Draft on the assessment of a sale within the context of a sale and leaseback transaction based on a performance obligation approach, prior to any decision on, and development of, an IPSAS drawn from IFRS 15, <i>Revenue from Contracts with Customers</i>. • The IPSASB decided not to adopt the lessor accounting requirements in IFRS 16, <i>Leases</i>.
December 2016	<p>The IPSASB decided to:</p> <ul style="list-style-type: none"> • Replace the term "peppercorn leases" with the term "concessionary leases"; • Measure leases that are exchange transactions at cost and measure concessionary leases at fair value; • Account for the subsidized component in a concessionary lease in the same way as in a concessionary loan.

LEASES PROJECT ROADMAP

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

Agenda Item 7.1.3

Meeting		Objective: IPSASB to consider:
	September	<ol style="list-style-type: none">1. Review of Responses: Presentation—Lessee and lessor (including "peppercorn leases")2. Review of Responses: Disclosures—Lessee and Lessor (including "peppercorn leases")3. Review of Responses: Sale and Leaseback Transactions4. Review of Responses: Terminology—Conceptual Framework
	December	<ol style="list-style-type: none">1. Review of draft IPSAS2. Approval of new IPSAS

Lessor—Analysis of lessor accounting approaches to the right-of-use model

Questions

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

Detail

2. At the December 2016 meeting (see [Agenda Item 9.2.1](#)), the IPSASB discussed two mutually exclusive approaches to lessor accounting and directed staff to carry out additional analysis of those approaches with sale and leaseback provisions, IPSAS 16, *Investment Property*¹, and explore when on a sliding scale (or spectrum) of transactions the transfer of the control of assets occurs.
3. The approaches to lessor accounting have the following recognition requirements:
 - (a) In Approach 1, the lessor:
 - (i) Continues to recognize the underlying asset in its entirety in the statement of financial position;
 - (ii) Recognizes a lease receivable (representing the present value of future lease payments by the lessee) in the statement of financial position; and
 - (iii) Recognizes a credit entry in the statement of financial position that will be reduced subsequently over the lease term as revenue is recognized the statement of financial performance.
 - (b) In Approach 2, the lessor:
 - (i) Derecognizes the portion ("slice") of the underlying asset from the statement of financial position that is transferred to the lessee ;
 - (ii) Recognizes a residual asset in the statement of financial position (representing the rights retained in the underlying asset or the right to receive back the underlying asset);
 - (iii) Recognizes a lease receivable in the statement of financial position;
 - (iv) Recognizes immediately the credit entry (representing the present value of future lease payments by the lessee) in the statement of financial performance; and
 - (v) Recognizes the lease expense (representing the cost of the portion of the underlying asset that is derecognized at the commencement of the lease) in the statement of financial performance.

¹ Staff extended the consistency analysis to IPSAS 17 because this Standard is applicable to public sector entities that lease plant or equipment. IPSAS 17 is also applicable to properties that:

- (a) Are leased to a third party under a finance lease;
- (b) Contains one portion held for either rental income or capital appreciation, and another portion held for other uses, the portions could not be sold and account separately, and the portion held for other uses is significant amount of the total asset value;
- (c) The lessor provides significant services to its occupants.

Agenda Item

7.2.1

4. The economic rationale of Approach 1 is that a lease is not a sale of assets because the individually controlled rights over the physical asset were not previously separately recognized in the lessor's statement of financial position. The physical asset is recognized and derecognized in its entirety, and not on a rights basis. In a lease, the lessor is granting to the lessee the right to use an asset that it still controls in its entirety.
5. The economic rationale of Approach 2 is that a lease is a sale of assets because the rights over the physical asset can be individually derecognized as portions ("slices") of the physical asset like any sale of assets.
6. Therefore, the main issues in the approaches to the right-of-use model for lessor accounting are:
 - (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 assets 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).
7. [Appendix A](#) below presents a description of both approaches, and a more detailed consistency analysis requested by IPSASB at the December 2016 meeting. This agenda item provides the most comprehensive analysis of the two lessor accounting approaches that has been carried out so far.
8. The criteria to analyze the two approaches to the right-of-use model for lessor accounting are the following:
 - (a) Consistency with IPSASB's existing literature²;
 - (b) Consistency with right-of-use model for lessee accounting³;
 - (c) Consequential amendments to other IPSASs⁴;
 - (d) Public sector specific issues⁵; and
 - (e) Public interest considerations on Approaches 1 and 2.
9. Staff notes that the above list does not imply a hierarchy in selecting an appropriate model for public sector financial reporting.
10. The main conclusions of the analysis are summarized in the following table:

² The Leases project is a convergence project guided by the IPSASB's Policy Paper [Process for Reviewing and Modifying IASB Documents](#) (also known as "Rules of the Road").

³ IPSASB's decision at the September 2016 meeting.

⁴ Task Based Group suggestion at the conference call on January 19, 2017. Staff notes that this criterion is not subject to an exhaustive analysis.

⁵ Task Based Group member suggestion on September 29th, 2016.

Agenda Item

7.2.1

Table 1 – Summary of consistency analysis of lessor accounting approaches

Criteria	Approach 1	Approach 2
I – Consistency with the IPSASB’s existing literature		
Recognition and derecognition of the underlying asset - entirety versus portions		
IPSAS 16 and IPSAS 17	Consistent	Not consistent
Sale and leaseback	Consistent	Not consistent
IPSAS 32	Consistent	Not consistent
Conceptual Framework	Consistent	Not consistent
Joint control	Not applicable to leases	
Recognition of credit entry		
IPSAS 32	Consistent	Not consistent
Conceptual Framework	Not conclusive	
Subsequent Measurement		
	Consistent with the principles in IPSAS 16 and IPSAS 17.	Not fully consistent with IPSAS 31 ⁶ because of exception in amortization.
II – Consistency with right-of-use model for lessee accounting		
Underlying asset	Identifies the entity which controls the underlying asset, but not the individual rights that are retained in the underlying asset. Consistent at type of asset level (the lessee controls the intangible right-of-use asset, and the lessor controls the physical asset)	Identifies the rights controlled by the lessor in the underlying asset, but not which entity controls the underlying asset in its entirety. 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 recognizes the physical asset.
Lease payments	Consistent	
III – Consequential amendments to other IPSASs		
	<ul style="list-style-type: none">Exclude the lease receivable from the fair value of the underlying asset for subsequent measurement of leased investment property.IPSAS 32 needs to be amended to replace the term “liability” with another term consistent with the Conceptual Framework.Depending on IPSASB’s decision, IPSAS 1 might also need to be amended to record the credit entry in the statement of financial position.	<ul style="list-style-type: none">Amend the principles in IPSAS 16, IPSAS 17 and IPSAS 32; orNew IPSAS on Leases would provide guidance on how to account for the individually controlled rights over the physical assets being leased. This guidance would be different from IPSAS 16, IPSAS 17 and IPSAS 32.
IV – Public Sector Specific Issues		
Accountability	Focus on physical asset in its entirety	Focus on individual rights over physical assets
Decision-making		
V – Public Interest Considerations		
	Physical asset is always recognized in the financial statements of lessor.	Physical asset is not recognized in the financial statements of lessee and lessor.

⁶ Staff notes that in Approach 2 the underlying asset is reclassified as a residual asset (intangible asset) representing the right to receive back the underlying asset.

Agenda Item 7.2.1

11. In relation to the underlying asset, Table 1 above shows that:
 - (a) Approach 1 is consistent with the principles in IPSAS 16, IPSAS 17, *Property, Plant, and Equipment* and IPSAS 32, *Service Concession Arrangements: Grantor* on recognition, while Approach 2 is not; and
 - (b) Approach 1 implies consequential amendments consistent with the principles in IPSAS 16, while the consequential amendments in Approach 2 implies breaking those principles or creating a Standard on Leases that is not consistent with IPSAS 16, IPSAS 17 and IPSAS 32.
12. In relation to the recognition of the credit entry, Approach 1 is consistent with the IPSAS 32 principle of recognizing revenue over the lease term in the statement of financial performance, and Approach 2 is not.
13. Overall, Approach 1 provides the most consistent accounting treatment with IPSASB's literature because:
 - (a) It does not conflict with the principles in IPSAS 16, IPSAS 17 and IPSAS 32 that the underlying assets are recognized/derecognized in their entirety because assets are not recognized/derecognized as portions ("slices") of individually controlled rights;
 - (b) It is consistent with a control-based approach to the recognition of assets because a lease does not transfer control of the underlying asset; and
 - (c) It recognizes revenue in a manner consistent with IPSAS 32.
14. 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/derecognition; and
 - (c) It does not recognize revenue in a manner consistent with IPSAS 32.
15. Therefore, staff recommends that the IPSASB adopts Approach 1 in the Exposure Draft on Leases.

Other Lessor Accounting Models

16. At the December 2016 meeting, the IPSASB raised the issues that:
 - (a) For transactions with no transfer of control over the underlying asset ("old" operating lease in IPSAS 13, *Leases*) it would be more appropriate to adopt Approach 1 (continuing to recognize the underlying asset in its entirety);
 - (b) For transactions with a clear transfer of control over the underlying asset ("old" finance lease in IPSAS 13) it would be more appropriate to adopt Approach 2 (derecognize portions of the underlying asset related to the transfer of the right to use the underlying asset); and
 - (c) Transactions could be viewed along a sliding scale (or spectrum) of transactions where the transfer of the control of assets would occur.

Agenda Item

7.2.1

17. The IPSASB also considered whether:
 - (a) For leases that are for a small part of the economic life of the underlying asset it would be more appropriate to adopt Approach 1 (continuing to recognize the underlying asset in its entirety); and
 - (b) For leases that are for most of, or all of, the economic life of the underlying asset it would be more appropriate to adopt Approach 2 (derecognize portions of the underlying asset related to the transfer of the right to use the underlying asset).
18. In this context, the key question is in what circumstances is it appropriate to apply Approach 1 or Approach 2?
19. These approaches to lessor accounting would lead to the existence of two or more lessor accounting models similar to the IFRS 16 for lessors.
20. Paragraphs 13-17 of Appendix A analyze the conditions when assets are derecognized. The main conclusions are:
 - (a) According to IPSASB's literature physical assets are always derecognized in their entirety on disposal or when no future economic benefits or service potential is expected from their use or disposal; and
 - (b) The right-of-use model is based on the transfer of the right to use an underlying asset for a period of time and not the transfer of control of the underlying asset.

TBG's comments

21. The TBG raised several issues related to the development of the Leases project, including:
 - (a) Questioning whether choosing one approach over the other is a workable solution, as both approaches are not fully consistent with IPSASB's literature, and because both approaches have their own merit and may be appropriate solutions depending on the economic substance of the individual lease transactions. As such, the TBG discussed whether:
 - (i) Other lessor accounting models could be drawn from a mix of both Approach 1 and Approach 2
 - (ii) Both approaches to the right-of-use model could exist simultaneously; and
 - (iii) Explore other different models.
 - (b) The discussion on lessor accounting should go beyond answering to questions on consistency with IPSASB's literature of lessor accounting approaches;
 - (c) The IPSASB should also assess the accounting implications of the proposed approaches.
22. In this context, the TBG also raised the possibility that both approaches to lessor accounting could be applied simultaneously, as follows:
 - (a) Transactions with a clear transfer of control at one end of the spectrum versus transactions with clearly no transfer of control at the other end of the spectrum, with various transactions in

Agenda Item

7.2.1

between where the assessment of whether control has transferred is not clear and will require significant judgment⁷; and

- (b) Leases for the whole economic life of the underlying asset versus leases not for the whole economic life of the underlying asset.

Staff's comments

23. Staff notes that:

- (a) At the September 2016 meeting, the IPSASB decided to adopt a single model for lessor accounting (the right-of-use model) and reaffirmed the decision that the Leases project is a convergence project guided by the IPSASB's "Rules of the Road");
- (b) After analyzing the IASB's lessor accounting models in their two Exposure Drafts, "the main conclusion of the TBG and staff is that the IASB's models were not consistent with the IPSASB's decision to adopt a symmetrical approach to lease accounting in the draft ED on Leases. The IASB's proposals apply dual models with two approaches each".⁸
- (c) The existence of two or more models for lessor accounting may necessitate reopening lessee accounting requirements.
- (d) The right-of-use model is about transferring the right to use an underlying asset for a period of time and not about the degree of control transferred over the underlying asset. In other words, if the transferor transfers the control of the underlying asset, then, in substance, the transaction is considered as a sale⁹. Consequently, there is no sliding scale in IFRS 16. Control is either transferred or not; there is no intermediate stage.

24. Staff does not support exploring other lessor accounting models because this would reopen previous IPSASB's decisions. Staff have not identified a fatal flaw in one or both approaches to the right-of-use model that may justify the exploration of other lessor accounting models. The TBG has not also identified what those other lessor accounting models would be, and how would they fit with IPSASB's previous decisions and IPSASB's literature.

Decisions required

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

- (a) Approach 1 to lessor accounting (continuing to recognize the underlying asset and recognizing the credit entry over the lease term in the statement of financial performance)?
- (b) Approach 2 to lessor accounting (derecognizing portions ("slices") of the underlying asset, recognizing immediately the credit entry and lease expense in the statement of financial performance)?

⁷ The TBG noted that this is in line with IPSASB's direction at the December 2016 meeting to explore when on a sliding scale (or spectrum) of transactions does the transfer of the control of assets occur.

⁸ Paragraph 8 [Agenda Item 9.2.1](#) of IPSASB December 2016 meeting

⁹ See paragraphs 42-49 of the Appendix A below on the discussion of the controlled based recognition criteria in IPSAS 32.9.

Agenda Item 7.2.1

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

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

1. This appendix provides a description of the two approaches to the right-of-use model. It also provides the more detailed analysis requested by IPSASB at the December 2016 meeting.
2. The Task Based Group (TBG) suggested extending the analysis to subsequent measurement of approaches to the right-of-use model and consequential amendments to other IPSASs.
3. The TBG also suggested extending the analysis to consider joint control in IPSAS 37, *Joint Arrangements*.
4. This appendix is divided into the following sections:
 - (a) Economic rationale of the right-of-use model;
 - (b) Main accounting requirements of the two mutually exclusive approaches to the right-of-use model;
 - (c) Consistency with IPSASB's existing literature;
 - (d) Consistency with right-of-use model for lessee accounting;
 - (e) Consequential amendments to other IPSASs;
 - (f) Public sector specific issues; and
 - (g) Public interest considerations on Approaches 1 and 2.

Economic Rationale

5. In the right-of-use model leases are financings of the right to use an underlying asset. The lessor grants the right to use an underlying asset to the lessee over a period of time in exchange for consideration.
6. Based on this economic rationale, the TBG and staff have identified two approaches¹⁰ for initial recognition in the accounts of lessors, based on whether:
 - (a) Physical assets are assets recognized/derecognized as a whole (Approach 1), as opposed to recognize/derecognize as portions of assets (rights) (Approach 2); and
 - (b) The credit entry is recognized over the lease term in the statement of financial performance (Approach 1), as opposed to recognize immediately (Approach 2).
7. The economic rationale of Approach 1 is that a lease is not a sale of assets because the individually controlled rights over the physical asset were not previously separately recognized in the lessor's statement of financial position. The physical asset is recognized and derecognized in its entirety, and

¹⁰ Approaches 1 and 2 are similar to the performance obligation and derecognition approach, respectively, in the IASB's 2010 ED. To access the IASB's 2010 ED, please click [here](#).

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

Agenda Item

7.2.1

not on a rights basis. In a lease, the lessor is granting to the lessee the right to use an asset that it still controls in its entirety.

8. The economic rationale of Approach 2 is that a lease is a sale of assets because the rights over the physical asset can be individually derecognized as portions ("slices") of the physical asset like any other sale of assets.
9. Therefore, the main issues in the approaches to the right-of-use model for lessor accounting are:
 - (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 assets 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).

Main accounting requirements of the two approaches to the right-of-use model

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

Table 2—Summary of approaches to right-of-use model in lessor accounting

Items	Approach 1	Approach 2
Statement of financial position (initial recognition)		
Underlying asset	Continues to recognize the underlying asset in its entirety.	<ul style="list-style-type: none">• Derecognizes the portion of the carrying amount of the underlying asset that represents the lessee's right to use the underlying asset during the term of the lease.• Reclassifies as a <i>residual asset</i> the remaining portion of the carrying amount of the underlying asset that represents the lessor's retained rights in the underlying asset and the right to receive back the underlying asset.
Lease receivable	Present value of future lease payments to be received during the lease term	
Credit entry	Recognizes the credit entry in the statement of financial position.	Does not recognize the credit entry in the statement of financial position
Initial measurement		
Asset	Underlying asset: continues to be recognized at historical cost.	Residual asset: Allocated amount of the carrying amount of the underlying asset (proportion of relative fair values) ¹¹
Revenue	Present value of future lease payments to be received during the lease term	
Subsequent measurement		

¹¹ The amount derecognized by the lessor is the carrying amount of the underlying asset multiplied by the fair value of the right to receive lease payments divided by the fair value of the underlying asset (all determined at the date of inception of the lease).

Agenda Item

7.2.1

Items	Approach 1	Approach 2
Asset	Underlying asset: Historical cost <ul style="list-style-type: none"> Continues to be recognized at historical cost Depreciation Impairment Fair value <ul style="list-style-type: none"> Revaluation model as in IPSAS 17 Fair value model in IPSAS 16 with adjustment for leased investment properties by excluding the lease receivable. 	Residual asset: Historical cost <ul style="list-style-type: none"> Remeasured according to the reassessment of the right to receive lease payments Impairment No amortization Fair value <ul style="list-style-type: none"> Revaluation model as in IPSAS 31
Lease receivable	Increases as interest revenue is earned; decreases as payments are received	
Revenue	The credit entry is reduced as revenue is recognized in the statement of financial performance.	N/A
Statement of financial performance		
Revenue	Interest revenue on the right to receive lease payments	
	<ul style="list-style-type: none"> Recognized as the performance obligation is satisfied 	<ul style="list-style-type: none"> Immediately representing the present value of the lease payments at the commencement date of the lease
Expense	Impairment	
	<ul style="list-style-type: none"> Depreciation 	<ul style="list-style-type: none"> Immediately representing the cost of the portion of the underlying asset that is derecognized at the date of commencement of the lease
Recognition at the end of the lease term		
	The underlying asset continues to be recognized and measured according to applicable Standards	<ul style="list-style-type: none"> Debit: Underlying asset Credit: Residual asset

Consistency with IPSASB's existing literature

Recognition and derecognition of the underlying asset - entirety versus portions

IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant, and Equipment*

11. IPSAS 16 and IPSAS 17 include recognition criteria that are, in substance, the same, as follows:
 - (a) It is probable that the future economic benefits or service potential that are associated with the *item* will flow to the entity; and
 - (b) The cost or fair value of the *item* can be measured reliably.
12. Neither IPSAS 16 nor IPSAS 17 recognize assets based on individual rights associated with the physical asset. Assets are recognized in their entirety. The one exception to this is where assets can be divided into distinct components. In such cases, components may be recognized separately. However, components are not portions of rights, but are distinct elements of the physical asset.
13. IPSAS 16 and IPSAS 17 also include similar derecognition criteria. Assets are derecognized:

Agenda Item 7.2.1

- (a) On disposal; or
 - (b) When no future economic benefits or service potential is expected from its use or disposal.
14. Neither IPSAS 16 nor IPSAS 17 derecognize assets based on individual rights associated with the physical asset. Assets are derecognized in their entirety. Components of assets may be derecognized separately from the rest of the physical asset, for example when a roof is replaced on a building. As discussed in paragraph 12 above, components are distinct elements of the physical asset, not individual rights.
15. The lessor continues to apply IPSAS 16 or IPSAS 17 in the accounting for the underlying asset (for example, depreciation or revaluation) in a lease arrangement. The Basis for Conclusions in IFRS 16, *Leases*, (paragraph BC140) makes it clear that leases do not transfer control of the underlying asset:
- “IFRS 16 applies to contracts that convey the right to use an underlying asset for a period of time and does not apply to transactions that transfer control of the underlying asset to an entity—such transactions are sales or purchases within the scope of other Standards...”
16. Consequently, as the lessor is not transferring the control of the underlying asset, the conditions for derecognition have not been met.
17. As a result of the above analysis, staff has concluded that:
- (a) Approach 1 is consistent with the recognition and derecognition criteria in IPSAS 16 and IPSAS 17 because the underlying asset is only derecognized on disposal or when no future economic benefits or service potential is expected from its use or disposal; and
 - (b) Approach 2 is not consistent with the recognition and derecognition criteria in IPSAS 16 and IPSAS 17 because the underlying asset is treated as a bundle of rights that can be recognized or derecognized separately.
18. The IPSASB also instructed staff to explore whether the transfer of control of an asset could be considered to occur on a sliding scale of transactions. Some Members suggested that:
- (a) For transactions with no transfer of control over the underlying asset (an operating lease under IPSAS 13) it would be more appropriate to continue to recognize the underlying asset in its entirety (Approach 1); for transactions with a clear transfer of control over the underlying asset (a finance lease under IPSAS 13) it would be more appropriate to derecognize a portion of the asset reflecting the rights transferred (Approach 2).
 - (b) For leases that are for a small portion of the economic life of the underlying asset it would be more appropriate to adopt Approach 1; for leases that are for most of or all of the economic life of the underlying asset it would be more appropriate to adopt Approach 2. In this context, the key question is what circumstances it is expected that control will transfer.
19. Staff considers that the approach identified in paragraph 18(a), in effect, retains the existing approach to lessor accounting in IPSAS 13. Staff does not consider that this approach can be justified on the basis of the transfer of control; as noted above (see paragraph 15), IFRS 16 does not apply to transactions that transfer control of the underlying asset. Such transactions are sales, and dealt with

Agenda Item

7.2.1

in other standards. Consequently, there is no sliding scale in IFRS 16. Control is either transferred or not; there is no intermediate stage.

20. Further support for this view is found in the sale and leaseback requirements in IFRS 16. IFRS 16 requires an entity to consider whether the transaction meets the definition of a sale (this is discussed in more detail in the following section and in [Agenda Item 7.2.4](#)). Where the transaction meets the definition of a sale, the entity accounts for the transfer of control of the underlying asset, and also accounts for the subsequent lease. Where the transaction does not meet the definition of a sale, the seller-lessee continues to recognize the underlying asset, and the transaction is accounted for as a financial instrument.
21. The recognition and derecognition criteria for sale and leaseback transactions in IFRS 16 are consistent with those in IPSAS 16 and IPSAS 17. The underlying asset is recognized or derecognized in its entirety, not as individual rights.
22. Staff considers that, for the same reasons as given in paragraph 17, Approach 1 is consistent with the sale and leaseback provisions in IFRS 16, whereas Approach 2 is not consistent with those provisions.

Sale and leaseback transactions

23. IFRS 16 contains new requirements on sale and leaseback transactions that differ from those in IAS 17, *Leases* and, therefore in IPSAS 13. IFRS 16 requires that a transfer of an asset is accounted for as a sale only if the transfer meets the requirements in IFRS 15, *Revenue from Contracts with Customers*. The IASB was of the view that this requirement “will be beneficial for both preparers and users of financial statements because it will increase comparability between sales entered into as part of a sale and leaseback transactions and all other sales.”¹²
24. IFRS 15 follows a *performance obligation* approach to recognize revenue from the transfer of goods and services to customers and is applicable to both lessee and lessor¹³.
25. According to IFRS 16, if the transfer of the underlying asset satisfies the requirements of IFRS 15 to be accounted for as a sale, the transaction will be accounted for as a sale (the seller-lessee derecognizes the underlying asset and the buyer-lessor recognizes the underlying asset) and a lease by both the lessee and the lessor. If not, the transaction is accounted for as a financing by both the seller-lessee and the buyer-lessor, and both apply IFRS 9, *Financial Instruments*.
26. In [Agenda Item 7.2.4](#) below, staff is proposing to replace the reference to IFRS 15 with IPSAS 9, *Revenue from Exchange Transactions*, while retaining the remaining requirements in IFRS 16. In the case that the transfer of the asset satisfies the requirements of IPSAS 9 to be accounted as a sale:
 - (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.

¹² IFRS 16.BC261

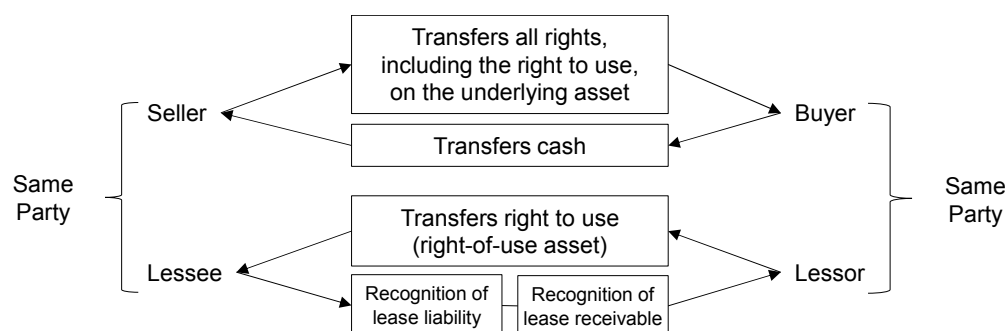
¹³ See IFRS 16. BC262-BC265 for further details on IASB’s rationale.

Agenda Item

7.2.1

- (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.”
27. The accounting requirements on sale and leaseback transactions are a good example on why the seller-lessee derecognizes the underlying asset in its entirety and recognizes a right-of-use asset (intangible asset), while the buyer-lessor continues to recognize the underlying in its entirety at the commencement date of the lease.
28. In a sale and leaseback, there is a loss of tangibility associated with the rights recognized in the seller-lessee's statement of financial position because the seller-lessee is transferring the whole rights (including the right to use the underlying asset) on the tangible asset (the underlying asset) and, afterwards, is buying back (leaseback) the right to use the underlying asset as an intangible asset (the right-of-use asset). This is illustrated in Figure 1.

Figure 1 – Sale¹⁴ and leaseback transactions



29. As the seller-lessee already had recognized in its financial statements the whole underlying asset, it will 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, so that the seller-lessee recognizes only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor.
30. Staff notes that the wording “retained” in the previous paragraph must be understood in the context of initial recognition and measurement of the right-of-use asset and not (re)measurement of the underlying asset because the buyer-lessor can only transfer the right to use an underlying asset to the seller-lessee if it has the power to do so (i.e., the buyer-lessor controls the right to use an underlying asset through the purchase of the underlying asset before transferring back that control to the seller-lessee).
31. Staff notes that the measurement of the right-of-use asset by the seller-lessee as a proportional measurement of the carrying amount of the underlying asset is justified because the seller-lessee is replacing one tangible asset (the underlying asset) by an intangible asset (the right-of-use asset) with completely different economic natures. The “remeasurement” procedure ensures that the value of the right-of-use asset only has the amounts corresponding to the rights purchased by the seller-lessee through the leaseback, and any gain or loss will be recognized only with the rights transferred to the buyer-lessor.

¹⁴ For simplicity reasons, staff uses the term “transfers all rights” with the meaning that the conditions for a sale are satisfied in order to derecognize the underlying asset.

Agenda Item 7.2.1

32. However, from the perspective of the buyer-lessor there is no loss of tangibility of the underlying asset that might justify its remeasurement or partial derecognition of the historical cost, as it happened with the seller-lessee. In a sale and leaseback transaction, the buyer-lessor is not exchanging a tangible asset by an intangible asset in the same way as the seller-lessee that could also lead to derecognition of portions (“slices”) of individual rights of the underlying asset being transferred. The lease itself does not “transform” the underlying asset for the lessor.
33. Once again, this reasoning is confirmed in the Basis for Conclusions of IFRS 16.BC140: “IFRS 16 applies to contracts that convey the right to use an underlying asset for a period of time and does not apply to transactions that transfer control of the underlying asset to an entity—such transactions are sales or purchases within the scope of other Standards (for example, IFRS 15 or IAS 16).”
34. The sale and leaseback is a good example where the transfer of rights can lead to the “transformation” of a tangible asset into intangible asset for one party (the seller-lessee), but not for the other party (the buyer-lessor). In the end, in a sale and leaseback:
 - (a) The seller-lessee “transformed” a tangible asset (the underlying asset) into an intangible asset (the right-of-use asset) through the exchange of the tangible asset for cash and recognizes the lease payments¹⁵ as a lease liability; and
 - (b) The buyer-lessor exchanged cash for a tangible asset (the underlying asset) and recognizes the lease payments as a lease receivable.
35. In Approach 1, the underlying asset will always be recognized by the buyer-lessor. Therefore, the buyer-lessor will continue to recognize the whole underlying asset according to applicable Standards¹⁶ (IPSAS 16 or IPSAS 17) (see above paragraph 26(b)).
36. In Approach 2, the underlying asset is derecognized in both seller-lessee’s and buyer-lessor’s accounts because:
 - (a) The seller-lessee recognizes an intangible asset (the right-of-use asset); and
 - (b) The buyer-lessor recognizes an intangible asset (the right to receive back the underlying asset).
37. Staff concludes that Approach 1 is consistent with the economic nature of the sale and leaseback transaction, and Approach 2 is not consistent because:
 - (a) In Approach 1, the underlying asset is still recognized in its entirety by the buyer-lessor after the transfer of the right to use the underlying asset to the seller-lessee), and the lessee recognizes an intangible asset (the right-of-use asset); and
 - (b) In Approach 2, the underlying asset is transformed into portions (“slices”) of individually controlled rights of physical asset retained by the lessor (i.e., the underlying asset loses its tangibility for accounting purposes only), even though, in reality, the underlying asset continues to exist.

¹⁵ Lease payments are payments by a lessee to a lessor relating to the right to use an underlying asset during the lease term.

¹⁶ As explained in paragraph 102 of this Appendix A, Approach 1 has two exceptions to subsequently measure the underlying asset.

Agenda Item

7.2.1

38. Staff notes that Approach 2 leads to a similar situation as IFRS 16, where the underlying asset might not be recognized by either lessee or lessor if the lessor classifies the lease as a finance lease. The IPSASB's decision to deviate from IFRS 16 was because of concerns about such an accounting outcome.

IPSAS 32, *Service Concession Arrangements: Grantor*

39. IPSAS 32 also provides guidance on the recognition and derecognition of assets. IPSAS 32 is intended to mirror IFRIC 12, *Service Concession Arrangements*. IFRIC 12 provides guidance on how an operator should account for service concession arrangements; IPSAS 32 provides the equivalent guidance for the grantor.
40. IFRIC 12 is an interpretation, not a separate standard. It interprets how, IAS 16, *Property, Plant and Equipment*, should be applied in accounting for service concession arrangements. IPSAS 17 is a converged standard with IAS 16, and the recognition and derecognition requirements of the two standards are identical.
41. The scope of IFRIC 12 is set out in paragraphs 5 and 6 of the Interpretation as follows:
- “5 This Interpretation applies to public-to-private service concession arrangements if:
- (a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
- (b) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the infrastructure at the end of the term of the arrangement.
- 6 Infrastructure used in a public-to-private service concession arrangement for its entire useful life (whole of life assets) is within the scope of this Interpretation if the conditions in paragraph 5(a) are met...”
42. Where a service concession arrangement is within the scope of IFRIC 12, the operator does not recognize the underlying asset but instead recognizes the rights they receive under the arrangement. This may be the right to receive payment from the grantor, or the right to charge third party users.
43. The scope set out in paragraphs 5 and 6 of IFRIC 12 can be directly related to the derecognition requirements in IAS 16 and IPSAS 17. This is because the operator would recognize the underlying asset as work in progress until control is transferred.
44. Where paragraphs 5(a) and 5(b) apply, the operator has transferred control of the asset to the grantor. This is in effect a disposal, the first criterion for derecognition of an asset under IAS 16 and IPSAS 17i.
45. Where paragraphs 5(a) and 6 apply, the operator will receive no future economic benefits from the asset; instead it will receive future economic benefits from the rights it receives under the service concession arrangement. Receiving no future economic benefits from the asset is the second criterion for derecognition of an asset under IAS 16 and IPSAS 17.
46. This analysis demonstrates that, under IFRIC 12, the underlying asset is not treated as a bundle of rights. The operator either does not recognize the underlying asset, or, where it had previously recognized the underlying asset, derecognizes it completely. (see paragraph 8 of IFRIC 12).

Agenda Item 7.2.1

47. IPSAS 32 provides guidance for the grantor and mirrors the requirements for the operator in IFRIC 12. Consequently, paragraphs 9 and 10 of IPSAS 32 mirror paragraphs 5 and 6 of IFRIC 12:
- “9. The grantor shall recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:
- (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
10. This Standard applies to an asset used in a service concession arrangement for its entire useful life (a “whole-of-life” asset) if the conditions in paragraph 9(a) are met.”
48. As with IFRIC 12, these paragraphs do not treat the underlying asset as a bundle of rights; a grantor recognizes the underlying asset in its entirety where the criteria in paragraphs 9 and 10 are met.
49. Where the criteria in paragraphs 9 and 10 are not met, the asset is not a service concession asset within the scope of IPSAS 32. The entity would consider other IPSASs in accounting for the transaction.
50. As a result of the above analysis, staff has concluded that:
- (a) Approach 1 is consistent with the recognition and derecognition criteria in IPSAS 32 and IFRIC 12 because the underlying asset is only derecognized on disposal or when no future economic benefits or service potential is expected from its use or disposal; and
 - (b) Approach 2 is not consistent with the recognition and derecognition criteria in IPSAS 32 and IFRIC 12 because the underlying asset is treated as a bundle of rights that can be recognized or derecognized separately.

Consistency with the Conceptual Framework

51. Chapter 5 of the Conceptual Framework discusses assets, and Chapter 6 of the Conceptual Framework sets out the criteria for the recognition/derecognition of assets.
52. Paragraph 5.6 of the Conceptual Framework defines an asset as “A resource presently controlled by the entity as a result of a past event.”
53. Paragraph 5.7 of the Conceptual Framework states that:
- “A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity’s rights to a variety of benefits including, for example, the right to:
- Use the resource to provide services;
 - Use an external party’s resources to provide services, for example, leases;
 - Convert the resource into cash through its disposal;
 - Benefit from the resource’s appreciation in value; or

Agenda Item 7.2.1

- Receive a stream of cash flows.”
54. In staff’s view, the underlying asset satisfies the definition of an asset. Staff considers that the right of use asset that a lessee recognizes under IFRS 16 also satisfies the definition of an asset. Staff notes that, according to IFRS 16, this is separate to the underlying asset, and exists as a result of the lease contract.
 55. Staff has not identified any provisions in the Conceptual Framework that suggest that the underlying asset can be recognized or derecognized as a bundle of rights.
 56. The recognition criteria are set out in paragraph 6.2 of the Conceptual Framework:
 - (a) An item satisfies the definition of an element; and
 - (b) Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.
 57. The derecognition criteria are set out in paragraph 6.10 of the Conceptual Framework:

“Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred. In evaluating uncertainty about the existence of an element the same criteria are used for derecognition as at initial recognition.”
 58. Staff considers that the underlying asset will meet the recognition criteria in the Conceptual Framework.
 59. Staff notes that the derecognition criteria refer to the removal of an item, not the portion of an item. As noted in paragraph 55 above, staff also has doubts that the individual rights that comprise the underlying asset meet the definition of an asset. Staff therefore considers that these rights would not meet the recognition and derecognition criteria in the Conceptual Framework.
 60. If the IPSASB does not agree with this conclusion, and considers that the individual rights that comprise the underlying asset meet the definition of a resource and hence an asset, staff considers that these may need to be recognized separately for all assets, as the different rights are likely to have different economic substances.
 61. Staff notes that some TBG members consider that, under Approach 1, the underlying asset may not satisfy the criterion that it can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs. This is because historical cost is one of the measurement bases used for the underlying asset, and these TBG members consider that:

“Historical cost overstates the assets because the same economic benefit (e.g., future cash flows from providing the right of use of the underlying asset) is represented twice in the statement of financial position: as a part of the historical cost of the asset, and as a lease receivable at the same time.”
 62. However, there are several counter arguments to this assertion:
 - (a) A lease does not negate the historical cost of the underlying asset incurred by the lessor.

Agenda Item

7.2.1

- (b) Different economic natures—The value of the underlying asset is the historical cost incurred to purchase it, and the lease asset is the present value of future lease payments that the lessor will receive for granting the right to use the underlying asset. The two assets result from 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 provides information on the amount that may be used as effective security for borrowings even when assets are being leased out, which is relevant to an assessment of financial capacity.
 - (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.
- 63. This issue was previously discussed at the December 2016 meeting.
- 64. Staff does not consider that the concerns raised by some members are such as to make the asset incapable of being measured in a way that achieves the QCs and takes account of constraints on information in GPFRs.
- 65. As a result of the analysis in paragraphs 51-64, staff has concluded that the Conceptual Framework does not support the recognition of a bundle of rights. Consequently, staff has concluded that Approach 1 is consistent with the Conceptual Framework, whereas Approach 2 is not.

Recognition of the credit entry

IPSAS 32, Service Concession Arrangements: Grantor

- 66. Both approaches to the right-of-use model involve the recognition of a credit entry. However, that credit entry is recognized differently, as follows:
 - (a) Approach 1 involves the recognition of the credit entry as revenue over the lease term in the statement of financial performance; and
 - (b) Approach 2 immediately recognizes revenue in the statement of financial performance.
- 67. IPSAS 32 is the closest comparable Standard to leases because it deals with transfers of rights over underlying assets to third-parties in exchange for consideration.
- 68. IPSAS 32 provides guidance to account for payments from the operator to the grantor in two cases:
 - (a) Grant of a right to the operator model with existing asset¹⁷; and
 - (b) Other revenues not related to previous sub-paragraph (a)¹⁸.

¹⁷ Paragraphs 24-26 of IPSAS 32

¹⁸ Paragraph 30 of IPSAS 32

Agenda Item

7.2.1

69. In both cases, the grantor recognizes the credit entry¹⁹ in the statement of financial position until the conditions for revenue recognition are met²⁰. The timing of revenue recognition by the grantor is determined by the terms and conditions of the arrangement—this is likely to be as the grantor provides the operator with access to the service concession asset²¹.
70. In Approach 1, an entity transfers the right of use asset as a separate asset to the underlying asset. This asset had not been previously recognized by the lessor. When the lessor transfers the right of use, it recognizes an asset (the lease receivable) and a credit entry (the nature of which still needs to be decided by the IPSASB) in the statement of financial position. The lessor does not immediately recognize revenue in the statement of financial performance as there is no sale of a previously recognized asset.
71. This approach is consistent with the “grant of a right to the operator” model in IPSAS 32. Under this model, the grantor does not make any payments for a service concession asset, but gives the operator the right to charge third party users. The grantor recognizes an asset (the service concession asset) and the credit entry in the statement of financial position. In developing IPSAS 32²², the IPSASB based revenue recognition on the requirements in IPSAS 9, *Revenue from Exchange Transactions*. Consequently, Approach 1 is also consistent with IPSAS 9 because revenue is recognized over the lease term in the statement of financial performance, rather than immediately.
72. The lessor has the same present obligation to the lessee of granting access to the underlying asset as the grantor has to the operator. Staff did not identify an economic reason to warrant a different accounting treatment related to that present obligation. Therefore, staff is of the view that the timing of revenue recognition by the lessor is the same as the grantor, i.e., during the term of the contract.
73. In Approach 2, an entity transfers the right of use asset, which had previously been recognized as a portion of the underlying asset. The lessor derecognizes the right of use asset from the physical asset and recognizes the lease receivable. This is consistent with the treatment of sale of an item under many IPSASs, including IPSAS 17 and IPSAS 9.
74. Consequently, staff considers that both approaches are consistent with IPSASB’s literature based on the assumptions they make. In other words, Approach 2 treats the right as a previously recognized item.
75. However, the analysis above shows that there is not a previously separately recognized right (an item) in the lessor’s financial statements. If the IPSASB accepts that there is no separately recognized right (an item), then only Approach 1 is consistent with IPSAS literature.

¹⁹ In IPSAS 32, the credit entry is labeled as “liability (unearned revenue)”. Paragraphs 76-89 discuss the economic nature of the credit entry. The importance of IPSAS 32 is related not to the label of the credit entry, but to the timing recognition of revenue in the statement of financial performance: over the lease term (Approach 1) versus immediately (Approach 2).

²⁰ See paragraphs AG47 and AG57 of IPSAS 32 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

²¹ See paragraphs AG47 and AG56 of IPSAS 32 for the grant of a right to the operator model (existing asset) and other revenues, respectively.

²² See IPSAS 32.BC35-BC39

Agenda Item

7.2.1

Consistency with Conceptual Framework

76. 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.

77. 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.”²³

Revenue:

“Increases in the net financial position of the entity, other than arising from ownership contributions”.²⁴

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.”

78. 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.

79. Staff has already concluded that the economics of a lease is not that of a sale of separately recognized asset. Therefore, revenue should not be recognized immediately in the statement of financial performance.

80. 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. The lease payments and the right-of-use asset recognized by the lessor are dissimilar²⁵ and generate an increase in the net assets of the lessor. However, views differ on the timing of recognition:

- (a) Some TBG members support initial recognition of the entire amount at inception of the lease in the statement of financial performance; and
- (b) Some TBG members support recognition over the lease term in the statement of financial performance.

²³ Paragraph 5.14 of the Conceptual Framework

²⁴ Paragraph 5.29 of the Conceptual Framework

²⁵ According to IPSAS 9, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue as it results in an increase in the net assets of the lessor.

Agenda Item

7.2.1

81. The Conceptual Framework does not link elements to a particular financial statement. Therefore, revenue may be initially recognized in any financial statement.
82. 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.
83. If the IPSASB initially recognizes the revenue 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.
84. 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).
85. If the IPSASB initially recognizes the revenue 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.
86. 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.
 - (b) Amend IPSAS 32 so that accounting for service concession arrangements is consistent with the accounting treatment of leases (i.e., initial recognition of revenue—rather than a liability—elsewhere in the statement of financial position and subsequent transfer to the statement of financial performance).
87. As noted in paragraph 81, the Conceptual Framework does not link elements to particular financial statements²⁶. However, staff considers that the recognition of revenue in the statement of financial

²⁶ Deferred inflows and deferred outflows were proposed as elements-limited to non-exchange transactions and for specified periods. This proposal was not carried forward into the finalized Conceptual Framework.
<http://www.ifac.org/system/files/publications/files/Conceptual%20Framework%20Exposure%20Draft%202%20FINAL%20November%208%2C%202012.pdf>

Agenda Item

7.2.1

position, is inconsistent with IPSASB's decision not to include deferred inflows and deferred outflows as elements in the Conceptual Framework. Therefore, the IPSASB included other obligations and other resources as possible approaches to addressing deferrals in the Conceptual Framework.

88. If the IPSASB decides to classify the credit entry as an other obligation, then the two possible accounting treatments will be the same as for revenue. Staff has concerns that this could be inconsistent with the definition of revenue (because the credit entry appears to meet the definition of revenue) and the IPSASB will need to explain why the credit should be classified as an other obligation. Staff will develop this further at the IPSASB meeting²⁷. Staff notes that, in IPSAS 32, the IPSASB concluded that the credit satisfies the definition of revenue. However, 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.
89. In conclusion, staff is of the view that, because the Conceptual Framework does not provide guidance on the timing of revenue recognition in the statement of financial performance, it is not possible to determine which of the two approaches to the right-of-use model is consistent with the Conceptual Framework.

Joint control term in IPSAS 37, Joint Arrangements

90. The TBG asked staff to consider how the requirements of IPSAS 37 in relation to joint control in IPSAS 37 apply to leases.
91. According to IPSAS 37, joint control is the agreed sharing of control by way of a binding arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.
92. In relation to its interest in a joint operation, IPSAS 37.23 requires that the joint operator recognizes:
 - (a) Its assets, including its share of any assets held jointly;
 - (b) Its liabilities, including its share of any liabilities incurred jointly;
 - (c) Its revenue from the sale of its share of the output arising from the joint operation;
 - (d) Its share of the revenue from the sale of the output by the joint operation; and
 - (e) Its expenses, including its share of any expenses incurred jointly.
93. IPSAS 37.24 states that "a joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IPSASs applicable to the particular assets, liabilities, revenues and expenses."
94. In a lease there is no sharing of control over the physical asset. As explained above in paragraph 15, in a lease the lessor transfers the control of the right to use the underlying asset to the lessee, while retaining control of the underlying asset.

²⁷ The issue is complex, but relates to the definition of revenue and the description of an other obligation, which is linked to net financial position. Further details of definitions and descriptions are in Chapter 5 of the Conceptual Framework.

Agenda Item 7.2.1

95. For the requirements on joint control in IPSAS 37 to be relevant to leases, the lessee and the lessor would need to have joint control over each of the rights associated with the underlying asset. This is not the case.
96. IPSAS 37 requires joint operators to recognize their interest in a joint operation. This is because a joint operator does not have separate control of the assets and liabilities, and therefore cannot recognize 100 percent of those assets and liabilities. In a lease, the lessee and lessor control separate assets, and can recognize 100 percent of those assets.
97. In other words, although the term “joint control” implies “slicing” the assets and liabilities in relation to the interest in a joint operation, it does not transform physical assets into individually controlled rights over the physical assets. The “slicing” of the physical assets into the percentage of control is economically different from the “slicing” of the physical asset into individually controlled rights (“slices of rights”) over the physical asset because:
- (a) The “slicing” of the physical asset into individually controlled rights (slices of rights) over the physical asset implies the “transformation” of a physical asset (the underlying asset) into an intangible asset in the lessor’s accounts, even though, in reality, the physical asset has not changed; and
 - (b) The joint control definition does not transform the economic nature of the assets and liabilities as described in (a), and only recognizes the percentage of control in the joint arrangement.
98. Staff has therefore concluded that the joint control definition does not apply to leases.

Consistency with right-of-use model for lessee accounting

99. Based on the assumptions they make, both approaches to the right-of use model for lessor accounting are broadly consistent with the right-of-use model for lessee accounting because:
- (a) The lessee recognizes in the statement of financial position:
 - (i) A right-of-use asset (representing the right to control the use of the underlying asset); and
 - (ii) A lease liability (representing the present value of future lease payments by the lessee);
 - (b) In Approach 1, the lessor:
 - (i) Continues to recognize the underlying asset in the statement of financial position;
 - (ii) Recognizes a lease receivable (representing the present value of future lease payments by the lessee) in the statement of financial position; and
 - (iii) Recognizes a credit entry in the statement of financial position that will be reduced subsequently over the lease term as revenue is recognized the statement of financial performance.
 - (c) In Approach 2, the lessor:
 - (i) Derecognizes the portion (“slice”) of the underlying asset from the statement of financial position that is transferred to the lessee ;

Agenda Item

7.2.1

- (ii) Recognizes a residual asset in the statement of financial position (representing the rights retained in the underlying asset or the right to receive back the underlying asset);
 - (iii) Recognizes a lease receivable in the statement of financial position;
 - (iv) Recognizes immediately the credit entry (representing the present value of future lease payments by the lessee) in the statement of financial performance; and
 - (v) Recognizes the lease expense (representing the cost of the portion of the underlying asset that is derecognized at the commencement of the lease) in the statement of financial performance.
100. Approach 1 identifies the entity which controls the underlying asset in its entirety, but not the individual rights that are retained in the underlying asset. On the other hand, Approach 2 identifies the rights controlled by the lessor in the underlying asset, but not which entity controls the underlying asset in its entirety (see paragraphs 116 and 117(a) below).
101. However, staff is of the view that Approach 1 is consistent with lessee accounting at type of asset level and Approach 2 is not because:
- (a) In Approach 1, the lessee controls the intangible right-of-use asset, and the lessor controls the physical asset; and
 - (b) In Approach 2, the lessee controls the intangible right-of-use asset, and the lessor controls the intangible right to receive back the underlying asset.
102. As explained in the above paragraph 15, the lessor still controls the underlying²⁸. As in Approach 2 neither the lessee nor the lessor recognizes the physical asset, then Approach 2 is not consistent with the type of asset it still controls. In other words, in Approach 2 although the lessor controls a physical asset, but recognizes an intangible asset.

Consequential amendments to other IPSASs

103. This section of the Appendix discusses the possible amendments to existing IPSASs that would be required by the two approaches.

Approach 1

104. In Approach 1, the initial recognition and measurement of the underlying asset would be consistent with current IPSASB's literature. However, the subsequent measurement of the underlying asset would need to include an amendment to the fair value model²⁹ in IPSAS 16.59(c), as follows:

59. In determining the fair value of investment property, an entity does not double-count assets or liabilities that are recognized as separate assets or liabilities.
For example:

...

²⁸ See IFRS 16.BC140

²⁹ IPSAS 16.49 states that: "The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions."

Agenda Item 7.2.1

- (c) The fair value of investment property excludes the lease receivable, and prepaid or accrued ~~operating lease~~ revenue, because the entity recognizes it as a separate liability or asset.
105. This consequential amendment to IPSAS 16 permits to be consistent with the principle of avoiding double-counting in the fair value model and extend it to the lease receivable. In this way, it addresses the duplication of values in the statement of financial position and, consequently, overstating the value of the assets.
106. In the view of staff the revaluation model in IPSAS 17 would still be applicable because according to IPSAS 17.45 the fair value of property, plant, and equipment is usually determined by appraisal, and not using the rental revenue from current leases as it is in investment property.
107. Regarding the credit entry (unearned revenue), staff is of the view that IPSAS 32 would need to be amended to replace the term “liability” with another term that the IPSASB decides to be more consistent with the Conceptual Framework. The above paragraphs 76-89 discuss the several options that the IPSASB has.

Approach 2

108. Approach 2 treats the underlying asset as a bundle of rights. As discussed in paragraph 60, the IPSASB will need to consider whether these individual rights meet the definition of an asset and should be recognized separately. This would be a significant departure from existing practice. The IPSASB would also need to consider whether this approach should be extended to all assets; and if not, why the granting of a lease transforms the economic substance of the underlying asset from that of a single asset into a bundle of separate assets. Staff also notes that this approach would require significant changes to IPSAS 16, IPSAS 17, and IPSAS 32. For example, a lessor may retain maintenance obligations, and replace a component of the underlying asset. How would this be allocated across the different rights? Allocating this across the different rights would be complex and arbitrary.
109. If the IPSASB considers that recognizing individual rights is required, the following amendments to other IPSASs will be required.
110. Under Approach 2 a residual asset would be recognized. This residual asset would not be amortized. Staff notes that IPSAS 31 requires the amortization of intangible assets unless they have an indefinite life, which is unlikely to apply to the residual amount.
111. In Approach 2, staff identified two options to deal with the recognition and measurement requirements of property, plant and equipment (PPE), investment property and services concession assets, as follows:
- (a) General guidance—all Standards on PPE, investment property and services concessions would provide guidance to recognize and measure individually controlled rights over the physical assets; or
 - (b) Specific guidance—the new IPSAS on Leases would provide guidance on how to account for the individually controlled rights over the physical assets being leased.

Agenda Item 7.2.1

112. In either case, guidance would be required on the classification of assets. The introduction of a residual amount requires a new class of assets.
113. In conclusion, the consequential amendments in Approach 1 have the advantage of simplicity because they maintain consistency with the principles in other IPSAS, while providing a minimum of consequential amendments to those IPSASs.
114. The consequential amendments in Approach 2 would require a more complex and significant revision of IPSASB's literature, either by introducing specific requirements for leased assets in multiple standards, or by excluding leased assets from those standards. In the latter case, requirements and guidance would also be needed on the transfer of the asset from its existing class to the new class of residual assets.
115. Staff notes that the guidance in IPSAS 16 to avoid double-counting in the fair value model shows that the possible inflation of assets in Approach 1 is resolved as a measurement issue and not as derecognition issue.

Public sector specific issues

116. The IPSASB has agreed that the Leases project is a convergence project with IFRS 16, and that amendments to the IASB's requirements should only be made where there is a public sector specific issue. The IPSASB has already identified lessor accounting as one such issue.
117. The public sector specific issues related to Approaches 1 and 2 that the IPSASB needs to consider are as follows:
 - (a) In Approach 1, the users of GPFRs will have information on physical assets a in the lessor's accounts, based on the principle of control. In Approach 2, the users of GPFRs will have information on the control of individual rights over physical assets. Staff notes that Approach 2 is likely to require amendments to IPSAS 16, IPSAS 17 and IPSAS 32, all of which are standards converged with IAS16, *Property, Plant, and Equipment*, IAS 40, *Investment Property*, and IFRIC 12, *Service Concession Arrangements*. The IPSASB has not previously identified a reason to depart from the main requirements of IAS 16, IAS 40, and IFRIC 12.
 - (b) In Approach 1, the lessor is accountable for the physical asset in its entirety. In Approach 2 the lessor is only accountable for the rights retained in the underlying asset, and no party is accountable for the physical asset.
118. As leasing transactions arise from a decision of the management of the public sector entity, the IPSASB will need to consider which approach best meets the objectives of public sector financial reporting of accountability and decision-making.

Public interest considerations on the approaches to the right-of-use model

119. It can be argued that in Approach 1 the public interest would be better met because physical assets would not be "transformed" into "slices" of individually controlled rights. However, it can also be argued that in Approach 2 the public interest would be better met because only the individual rights over physical assets that the lessor controls would be reflected in the financial statements.

Agenda Item 7.2.1

120. Staff is of the view that disaggregating physical assets into “slices” of individually controlled rights might impair the understandability of leasing transactions because physical assets would be treated like any other rights. The unique economic substance of a physical asset would not be reflected in the financial statements.
121. Staff is also of the view that derecognizing portions of physical assets might impair the faithful representation of leasing transactions because leases are also viewed as means of earning income from managing physical assets—the management of the lessor has always an option to sell or to use the physical asset in its own operations.
122. The “transformation”³⁰ of physical assets could imply that the lessor has lost control of those physical assets. Information to hold the entity accountable for the physical asset would not be available in the financial statements. In Approach 2, the underlying asset would not be reported in either the lessee’s or the lessor’s accounts.
123. In conclusion, staff has reservations whether treating physical assets as portions (“slices”) of rights meets the objectives of public sector financial reporting and, consequently, the public interest.

³⁰ The term “transformation” is used with the meaning of derecognition of the physical asset (the underlying asset) and recognition of an intangible asset (right to receive back the underlying asset) by the lessor.

Leases for zero or nominal consideration

Question

1. Does the IPSASB agree with staff's analysis on leases for zero or nominal consideration?

Detail

2. The IPSASB's [Project Brief on Leases](#) included in the scope of the Leases project leases that are not exchange transactions as defined in *The Glossary of Defined Terms for IPSAS*³¹, also known as concessionary leases³².
3. At the December 2016, the IPSASB decided to:
 - (a) Measure leases that are exchange transactions at cost and measure concessionary leases at fair value; and
 - (b) Account for the subsidized component of concessionary leases in the same way as for concessionary loans.
4. However, until now the IPSASB still has not decided on where and how to provide requirements and guidance for concessionary leases in the Leases project.
5. The Task Based Group (TBG) and staff have identified two types of concessionary leases:
 - (a) Leases for zero or nominal consideration³³—This type of lease is in substance a grant or a donation from the lessor to the lessee because there is no present obligation to make payments to the lessor, or the payments are so low (for example, one dollar/euro per year or month) that, in substance, there is no present obligation to make payments to the lessor in exchange for the right to use the underlying asset.
 - (b) Leases above zero or nominal consideration, but below fair value—In this type of lease there is consideration, but it is below fair value.
6. The first type of leases identified in the previous paragraph raises several issues in the development of the Leases project because they are:
 - (a) In substance a grant or a donation in kind;
 - (b) Inconsistent with the economic rationale of right-of-use model—Leases are financings of the right to use an underlying asset;
 - (c) Inconsistent with the definition of leases—The definition of lease in IFRS 16 contains the wording “in exchange for consideration”; and

³¹ Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

³² The Project Brief labelled this type of leases as “peppercorn leases”. At the December 2016 meeting, the IPSASB decided to replace the term “peppercorn leases” with the term “concessionary leases”.

³³ Staff notes that in some jurisdictions leases without consideration might not be a legally enforceable contract.

Agenda Item

7.2.2

- (d) Inconsistent with concessionary loans—All loans have a repayment obligation, even if the principal and interest rate have a concessionary nature. In a lease there is always an obligation to return the underlying asset.

7. The TBG and staff have identified two options to deal with leases for zero or nominal consideration in the Exposure Draft on Leases, as follows:

Table 1 – Options for guidance on leases for zero or nominal consideration

Criteria	Option 1	Option 2
Donation in kind vs financing transaction	<ul style="list-style-type: none"> Leases for zero or nominal consideration would be treated in the Non-Exchange Expense project and IPSAS 23, <i>Revenue from Non-Exchange Transactions</i> like any other donation in kind. The current IPSASB's project on Revenue and Non-Exchange Expense would include the guidance on such transactions. 	<ul style="list-style-type: none"> Leases for zero or nominal consideration would be treated in the Leases project along with the leases that are above nominal consideration, but below fair value.
Definition of a lease³⁴	<ul style="list-style-type: none"> The IFRS 16 definition of a lease would be retained. 	<ul style="list-style-type: none"> The IFRS 16 definition of a lease would be amended to remove the wording "in exchange for consideration" to include a public sector specific transaction.
Concentration vs dispersion of subject in IPSASs	<ul style="list-style-type: none"> Include guidance on concessionary leases in the IPSAS on Leases that are similar to concessionary loans in IPSAS 29, <i>Financial Instruments: Recognition and Measurement</i> (i.e., with repayment obligation). Amend IPSAS 23 in the same way as for concessionary loans. 	<ul style="list-style-type: none"> Include guidance on both types of concessionary leases. Amend IPSAS 23 in the same way as for concessionary loans.

8. The TBG and staff have identified the following advantages and disadvantages of both options, as follows:

³⁴ The IFRS 16 definition of 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."

Agenda Item

7.2.2

Table 2 – Advantages and disadvantages of options for guidance on leases for zero or nominal consideration

Criteria	Option 1	Option 2
Advantages	<ul style="list-style-type: none"> • Maintains consistency with the IFRS 16 definition of a lease. • Increases internal consistency of IPSAS on Leases because includes only transactions that have the same economic nature. • Increases consistency with IPSAS 29. 	<ul style="list-style-type: none"> • Preparers will find guidance on all types of “leases” or arrangements with some of the characteristics of a lease as currently defined in a single Standard.
Disadvantages	<ul style="list-style-type: none"> • Preparers need to find guidance on leases in different Standards depending on whether there is or not consideration. • There will be no guidance on how to account for the subsidized component from the lessor side until the new Standard on Non-Exchange Expense is approved. 	<ul style="list-style-type: none"> • Does not maintain consistency with the IFRS 16 definition of a lease. • Lack of consistency in the IPSAS on Leases because includes transactions with different economic natures. • Lack of consistency with IPSAS 29.

9. Staff does not expect different accounting of the subsidized component for both lessors and lessees because the IPSASB has already decided to:
 - (a) Measure leases that are exchange transactions at cost and measure concessionary leases at fair value; and
 - (b) Account for the subsidized component of concessionary leases in the same way as for concessionary loans.
10. Staff proposes that the Exposure Draft on Leases will include guidance for leases above zero or nominal consideration, but below fair value, as IPSAS 29 does for concessionary loans.
11. [Appendix A](#) below provides a draft version of both options for the Exposure Draft on Leases. Option 1 and Option 2 provide guidance for the subsidized component from the lessee side that is similar to concessionary loans. However, the guidance for lessor accounting for leases for zero or nominal consideration would be provided as follows:
 - (a) In Option 1, by cross-referencing to the relevant international or national accounting standard until a new IPSAS on Non-Exchange Expenses is published;
 - (b) In Option 2, in the Exposure Draft on Leases.
12. Staff notes that accounting for the credit entry in lessor accounting is dependent on IPSASB's decision in Agenda Item 7.2.1.
13. If the IPSASB decides to propose Approach 1, the credit entry is recorded in the statement of financial position. If the IPSASB decides to propose Approach 2, the credit entry is recorded in the statement of financial performance. In Option 1 and in the context of leases for zero or nominal consideration, the IPSASB will need to decide whether the economic nature of the credit entry would lead to the recognition principle (over the lease term) that will be wound down during the lease term as revenue

Agenda Item 7.2.2

in the statement of financial performance, or if it should be revenue recognized immediately in the statement of financial performance³⁵.

14. Both options will require consequential amendments to IPSAS 23 in order to include guidance for concessionary leases in the same way as for concessionary loans³⁶.

Decision required

15. 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 1)?

³⁵ Staff notes that the debit entry in both approaches is the lease receivable.

³⁶ See IPSAS 23.105A-105B

APPENDIX A – Draft text for Exposure Draft on Leases based on Option 1 and Option 2**Option 1 – Leases for zero or nominal consideration are in substance a grant or donation in kind****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

Concessionary leases

- AG1. 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.
- AG2. As concessionary leases are granted or received at below market terms, the transaction price on initial recognition of the lease may 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 AG3 and AG4 below.
- AG3. 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 is received by an entity, the grant is accounted in accordance with IPSAS 23.
 - (b) Where the concessionary lease is granted by an entity, the grant is accounted according to the relevant international or national accounting standard.
- AG4. 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 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.

Agenda Item 7.2.2

Illustrative examples are provided in paragraphs IGXX of IPSAS 23 as well as paragraphs IEXX-IEXX accompanying this Standard.

Basis for Conclusions

Objective, Scope and Definitions

- BC1. The IPSASB considered the economic substance of several types of concessionary leases. The IPSASB is of the view that leases for zero or nominal amount are in substance a grant or donation in kind.
- BC2. Therefore, the IPSASB decided to exclude from the scope of the IPSAS XX, *Leases* this type of public sector specific lease. As a consequence, the IPSASB decided to retain the wording “in exchange for consideration” in IFRS 16 definition of a lease.

Concessionary leases

- BC3. As stated in paragraph BC1, the IPSASB is of the view that leases for zero or nominal amount are in substance a grant or donation in kind.
- BC4. IPSAS 23, *Revenue from Non-Exchange Transactions* already provides guidance to account for such transactions from the recipient side. That guidance is also applicable to the subsidized component of leases for zero or nominal amount 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.

Option 2 – Leases for zero or nominal consideration are still leases

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.

Application Guidance

Concessionary leases

- AG1. Concessionary leases are granted to or received by an entity at below market terms. Examples of concessionary leases granted by entities include leases to international organizations or to other public sector entities with public policy objectives.
- AG2. As concessionary leases are granted or received at below market terms, the transaction price on initial recognition of the lease may 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 AG3 and AG4 below.
- AG3. If an entity has determined that the lease has, in full or in part, a subsidized component, that component is treated as follows:

Agenda Item 7.2.2

- (a) Where the concessionary lease is received by an entity, the subsidized component is accounted in accordance with IPSAS 23.
- (b) Where the concessionary lease is granted by an entity, the subsidized component 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 IGXX of IPSAS 23 as well as paragraphs IEXX-IEXX accompanying this Standard.

Basis for Conclusions

Definitions

- BC1. The IPSASB considered the economic substance of several types of concessionary leases. The IPSASB is of the view that a lease for zero or nominal amount is still a lease.
- BC2. Therefore, the IPSASB amended the IFRS 16 definition of a lease to remove the wording “in exchange for consideration” in order to capture this public sector specific transaction. As a consequence, this Standard includes guidance related to all types of leases whether it is in exchange for consideration or not.

Concessionary leases

- BC3. As stated in paragraph BC1, the IPSASB is of the view that a lease for zero or nominal amount is still a lease.
- BC4. IPSAS 23, *Revenue from Non-Exchange Transactions* already provides guidance to account for concessionary loans from the recipient side. That guidance is also applicable to the subsidized component of leases for zero or nominal amount from the lessee side.
- BC5. This Standard also provides the guidance to account the subsidized component of leases for zero or nominal amount from the lessor side in the same way as leases above zero or nominal consideration, but below fair value and concessionary loans.

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

1. Does the IPSASB agree with staff's analysis on lessee accounting for:
 - (a) Reassessment of the lease liability;
 - (b) Lease modifications;
 - (c) Separating components of a contract (lessee side); and
 - (d) Lease term?

Detail

2. IFRS 16, *Leases*, includes requirements for lessees on reassessment of the lease liability and lease modifications.
3. [Appendix A](#) below provides draft sections of the Exposure Draft (ED) XX, *Leases* (marked-up from IFRS 16) on reassessment of the lease liability and lease modifications.
4. Staff did not identify a public sector specific reason not to apply the IFRS 16 requirements on reassessment of the lease liability and lease modifications in the ED.
5. Staff notes that these sections refer to a lease as a contract. Staff also notes that the definition of a lease might be revised because, in the public sector, leases may be binding arrangements that do not take the form of legal contracts. Staff expects this issue to be discussed at the June 2017 IPSASB meeting.
6. In the draft sections of the ED on reassessment of the lease liability and lease modifications, there are links to other parts of IFRS 16, namely: (i) separating components of a contract from the lessee side³⁷, and (ii) lease term.
7. [Appendix A](#) below also provides draft sections of the Exposure Draft XX, *Leases* (marked-up from IFRS 16) on these issues.
8. Staff did not identify a public sector specific reason not to apply the IFRS 16 requirements on separating components of a contract (from the lessee side) and lease term.

Decisions required

9. 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

³⁷ Staff does not address the issue of separating components of a contract from the lessor side because the lessor accounting model is still under discussion.

Agenda Item 7.2.3

(d) Lease term?

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

EXPOSURE DRAFT XX, LEASES (MARKED-UP³⁸ FROM IFRS 16, LEASES)

Separating components of a contract

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

Lessee

- 13 For a contract that contains a lease component and one or more additional lease or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the relative stand-alone price of the lease component and the aggregate stand-alone price of the non-lease components.
- 14 The relative stand-alone price of lease and non-lease components shall be determined on the basis of the price the lessor, or a similar supplier, would charge an entity for that component, or a similar component, separately. If an observable stand-alone price is not readily available, the lessee shall estimate the stand-alone price, maximizing the use of observable information.
- 15 As a practical expedient, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component. A lessee shall not apply this practical expedient to embedded derivatives that meet the criteria in paragraph ~~4.3.3 of IFRS 9~~ *Financial Instruments* 12 of IPSAS 29, *Financial Instruments: Recognition and Measurement*.
- 16 Unless the practical expedient in paragraph 15 is applied, a lessee shall account for non-lease components applying other applicable Standards.

...

Lease term

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

³⁸ The text is not marked-up for amendments related to North American English or IPSASB's editorial style. The paragraph numbering of IFRS 16 is retained in this Appendix only to facilitate the cross-referencing. In the Exposure Draft XX, *Leases* the paragraph numbering will be updated. As a consequence, the paragraph number in all cross-references in this draft Exposure Draft might be amended in the final Exposure Draft.

Agenda Item 7.2.3

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

Lessee

Recognition

...

Measurement

Initial measurement

Initial measurement of the right-of-use asset

...

Initial measurement of the lease liability

...

Agenda Item 7.2.3

Subsequent measurement

Subsequent measurement of the right-of-use asset

...

Cost model

...

Other measurement models

Subsequent measurement of the lease liability

...

Reassessment of the lease liability

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

Agenda Item 7.2.3

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

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

Lease modifications

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

Application Guidance**Separating components of a contract (paragraphs 12–17)**

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

Lease term (paragraphs 18–21)

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

Agenda Item 7.2.3

- (i) The amount of payments for the lease in any optional period;
 - (ii) The amount of any variable payments for the lease or other contingent payments, such as payments resulting from termination penalties and residual value guarantees; and
 - (iii) The terms and conditions of any options that are exercisable after initial optional periods (for example, a purchase option that is exercisable at the end of an extension period at a rate that is currently below market rates).
- (b) Significant leasehold improvements undertaken (or expected to be undertaken) over the term of the contract that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (c) Costs relating to the termination of the lease, such as negotiation costs, relocation costs, costs of identifying another underlying asset suitable for the lessee's needs, costs of integrating a new asset into the lessee's operations, or termination penalties and similar costs, including costs associated with returning the underlying asset in a contractually specified condition or to a contractually specified location;
- (d) The importance of that underlying asset to the lessee's operations, considering, for example, whether the underlying asset is a specialized asset, the location of the underlying asset and the availability of suitable alternatives; and
- (e) Conditionality associated with exercising the option (i.e., when the option can be exercised only if one or more conditions are met), and the likelihood that those conditions will exist.
- B38 An option to extend or terminate a lease may be combined with one or more other contractual features (for example, a residual value guarantee) such that the lessee guarantees the lessor a minimum or fixed cash return that is substantially the same regardless of whether the option is exercised. In such cases, and notwithstanding the guidance on in-substance fixed payments in paragraph B42, an entity shall assume that the lessee is reasonably certain to exercise the option to extend the lease, or not to exercise the option to terminate the lease.
- B39 The shorter the non-cancellable period of a lease, the more likely a lessee is to exercise an option to extend the lease or not to exercise an option to terminate the lease. This is because the costs associated with obtaining a replacement asset are likely to be proportionately higher the shorter the non-cancellable period.
- B40 A lessee's past practice regarding the period over which it has typically used particular types of assets (whether leased or owned), and its economic reasons for doing so, may provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. For example, if a lessee has typically used particular types of assets for a particular period of time or if the lessee has a practice of frequently exercising options on leases of particular types of underlying assets, the lessee shall consider the economic reasons for that past practice in assessing whether it is reasonably certain to exercise an option on leases of those assets.
- B41 Paragraph 20 specifies that, after the commencement date, a lessee reassesses the lease term upon the occurrence of a significant event or a significant change in circumstances that is within

Agenda Item 7.2.3

the control of the lessee and affects whether the lessee is reasonably certain to exercise an option not previously included in its determination of the lease term, or not to exercise an option previously included in its determination of the lease term. Examples of significant events or changes in circumstances include:

- (a) Significant leasehold improvements not anticipated at the commencement date that are expected to have significant economic benefit for the lessee when the option to extend or terminate the lease, or to purchase the underlying asset, becomes exercisable;
- (b) A significant modification to, or customization of, the underlying asset that was not anticipated at the commencement date;
- (c) The inception of a sublease of the underlying asset for a period beyond the end of the previously determined lease term; and
- (d) A business decision of the lessee that is directly relevant to exercising, or not exercising, an option (for example, a decision to extend the lease of a complementary asset, to dispose of an alternative asset or to dispose of a business unit within which the right-of-use asset is employed).

Sale and leaseback transactions

Question

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

Detail

2. This agenda item is divided into separate issues, as follows:
 - (a) Draft text to be included in the core Standard and in the Basis for Conclusions; and
 - (b) IFRS 16 consequential amendments to IFRS 15, *Revenue from Contracts with Customers*.

Draft text to be included in the core Standard and in the Basis for Conclusions

3. At the September 2016 meeting, the IPSASB decided to adopt the IFRS 16 section on sale and leaseback transaction and replace the reference to IFRS 15 and IFRS 9 with IPSAS 9 and IPSAS 29, respectively. The IPSASB also directed staff to draft text on guidance to be included in the core Standard and a draft Basis for Conclusions on why the IPSASB took this decision.
4. [Appendix A](#) provides draft text, marked-up for changes from IFRS 16, *Leases*, to be included in the core text of the Exposure Draft on Leases and a draft Basis for Conclusions for IPSASB's consideration.

Consequential amendments to IFRS 15

5. IFRS 16 includes several consequential amendments to the Application Guidance of IFRS 15 in the repurchase agreements section (IFRS 15.B64-B76), as follows:

A forward or a call option

B66 If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset because the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset. Consequently, the entity shall account for the contract as either of the following:

(a) a lease in accordance with ~~IAS 17~~ IFRS 16 Leases if the entity can or must repurchase the asset for an amount that is less than the original selling price of the asset, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with IFRS 9; or

(b) ...

A put option

B70 If an entity has an obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether the customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Therefore, if the customer has a significant economic incentive to exercise that right, the entity shall account for the agreement as a lease in accordance with ~~IAS 17~~ IFRS 16, unless the contract is part of a sale

Agenda Item

7.2.4

and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with IFRS 9.

...

6. The IPSASB does not have an equivalent to IFRS 15. The IPSASB has indicated that it will develop an IPSAS primarily drawn from IFRS 15 to replace IPSAS 9 and IPSAS 11. However, such an IPSAS is unlikely to be approved until 2019.
7. IPSAS 9 includes Implementation Guidance on sale and repurchase agreements, as follows:

Sale And Repurchase Agreements (Other than Swap Transactions) under Which the Seller Concurrently Agrees to Repurchase the Same Goods at a Later Date, or when the Seller has a Call Option to Repurchase, or the Purchaser has a Put Option to Require the Repurchase by the Seller of the Goods

IG22. The terms of the agreement need to be analyzed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the purchaser, and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

Real Estate Sales

IG27. In some cases, real estate may be sold with a degree of continuing involvement by the seller, such that the risks and rewards of ownership have not been transferred. Examples are (a) sale and repurchase agreements that include put and call options, and (b) agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the purchaser's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing, or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

8. As indicated above the IPSASB does not have an equivalent of IFRS 15. Therefore, staff have identified two options for dealing with the consequential amendments to IFRS 15 in IFRS 16, as follows:
 - (a) 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
 - (b) Options 2—Include the IFRS 15 guidance on repurchase agreements (including the guidance on sale and leaseback) in IPSAS 9.
9. Option 1 maintains the current situation in IPSAS 9, where the guidance is based on risks and rewards, without guidance in the context of sale and leaseback transactions. However, it has the disadvantage of not having consistency with IFRS 15 and IFRS 16 in repurchase agreements.
10. Option 2 has the advantage of meeting the objective of IFRS 15 and IFRS 16 in ensuring a consistent treatment of sale and leaseback in the context of repurchase agreements. However, it has the major

Agenda Item 7.2.4

disadvantage of amending IPSAS 9 with new guidance based on control in a Standard based on risks and rewards and, as a consequence, creates an internal conceptual inconsistency in IPSAS 9.

11. Additionally, the IFRS 15 guidance on repurchase agreements needs to be assessed for public sector financial reporting. This assessment will take place when an Exposure Draft primarily drawn from IFRS 15 is developed as part of the IPSASB's project on Revenue and Non-Exchange Expense.
12. On balance, staff recommends the IPSASB to choose Option 1 because the internal conceptual inconsistency that Option 2 implies can have unpredictable harmful consequences in the applicability of IPSAS 9.
13. Staff notes that the [Appendix A](#) below is not related to the sale and leaseback transactions in the context of repurchase agreements.

Decision required

14. Does the IPSASB:
 - (a) Agree with the draft section on sale and leaseback transactions in the Exposure Draft on Leases, including the Basis for Conclusions?
 - (b) 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?

Appendix A – Exposure Draft Section on Sale and Leaseback Transactions

EXPOSURE DRAFT XX, *LEASES*

Sale and leaseback transactions (marked-up³⁹ from IFRS 16, *Leases*)

~~981~~⁴⁰. 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 ~~992–1036~~.

Assessing whether the transfer of the asset is a sale

~~992~~. An entity shall apply the requirements ~~for determining when a performance obligation is satisfied in IFRS 15~~ 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

~~1003~~. If the transfer of an asset by the seller-lessee satisfies the requirements of ~~IFRS 15~~ 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.

~~1014~~. 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.

~~1025~~. The entity shall measure any potential adjustment required by paragraph ~~1014~~ 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.

³⁹ The text is not marked-up for amendments related to North American English or IPSASB's editorial style.

⁴⁰ Paragraph numbering will be updated in full draft ED.

Agenda Item

7.2.4

Transfer of the asset is not a sale

~~1036~~. If the transfer of an asset by the seller-lessee does not satisfy the requirements of ~~IFRS 15~~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 ~~IFRS 9~~IPSAS 29, *Financial Instruments: Recognition and Measurement*⁴¹.
- (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 ~~IFRS 9~~IPSAS 29.

Basis for Conclusions

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

Sale and leaseback transactions

1. The IPSASB considered the requirement in IFRS 16, *Leases*, 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*.
2. The IPSASB is of the view that a sale entered into as part of a sale and leaseback transaction should be accounted in the same way as other sales of goods. However, currently the IPSASB does not have an IPSAS primarily drawn from IFRS 15. IPSAS 9, *Revenue from Exchange Transactions* follows a risks and rewards of ownership approach to the recognition of revenue from the sale of goods, rather than the control-based approach in IFRS 15.
3. 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*.

⁴¹ 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*.