AT A GLANCE
January 2018

Exposure Draft (ED) 64 Summary—*Leases*

This summary provides an overview of Exposure Draft 64, *Leases*.

Project objective:	This ED proposes new requirements for lease accounting covering both lessors and lessees to replace IPSAS 13, *Leases*.
Development of ED 64:	The IPSASB's Leases project is a convergence project with IFRS 16, *Leases*. In developing ED 64, the IPSASB applied its Policy Paper on *Process for Reviewing and Modifying IASB Documents*. Based on this process, the IPSASB proposes to adopt the IFRS 16 right-of-use model for lessees. However, the IPSASB decided not to adopt the IFRS 16 risks and rewards incidental to ownership model for lessors. Instead, the IPSASB is also proposing the right-of-use model for lessors. The IPSASB is also proposing new public sector specific guidance on concessionary leases for both lessors and lessees.
The project stage:	The IPSASB issued this ED in January 2018.
Next steps:	The IPSASB seeks feedback on ED 64 to guide it in developing a final International Public Sector Accounting Standard® (IPSAS®) that revises accounting requirements for leases.
Comment deadline:	ED 64 is open for public comment until June 30, 2018.
How to respond:	Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file. All comments will be considered a matter of public record and will ultimately be posted on the website.

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Why the IPSASB Undertook this Project?

IFRS 16 replaces IAS 17. As IPSAS 13 was based on IAS 17, the IPSASB decided to revise its leasing requirements in order to maintain convergence with the underlying IFRS, where appropriate.

IFRS 16, *Leases*

IPSAS 13, *Leases* was drawn primarily from International Accounting Standard (IAS) 17, *Leases*, issued by the International Accounting Standards Board (IASB). In January 2016, the IASB issued International Financial Reporting Standard (IFRS) 16, *Leases*. IFRS 16 replaces IAS 17 and a number of related interpretations.

The IASB's goal was to address stakeholder criticism that the IAS 17 risks and rewards incidental to ownership model:

(a) Did not require lessees to recognize assets and liabilities arising from operating leases;

(b) Had two different accounting models for leases that allowed transactions that were economically similar to be accounted for very differently; and

(c) Did not provide adequate information about a lessor's exposure to credit risk and asset risk.

In this context, the IPSASB decided to revise its leasing requirements in order to address the same issues in the public sector, while maintaining convergence with IFRS 16, where appropriate.

Concessionary leases

Quite often public sector entities and international organizations enter into a lease at below market terms (a concessionary lease). IFRS 16 requires leases to be measured at cost. Applying IFRS 16 measurement requirements to concessionary leases would lead to an understatement of the right-of-use asset and no recognition of the subsidy from the lessor to the lessee in the financial statements of both the lessor and the lessee.

Therefore, the IPSASB decided to propose new public sector specific requirements to account for concessionary leases in ED 64.

Development of ED 64—Lessee accounting

The IPSASB's Leases project is a convergence project with IFRS 16, *Leases* that follows IPSASB's policy document *Process for Reviewing and Modifying IASB Documents,* also known as "*Rules of the Road*".

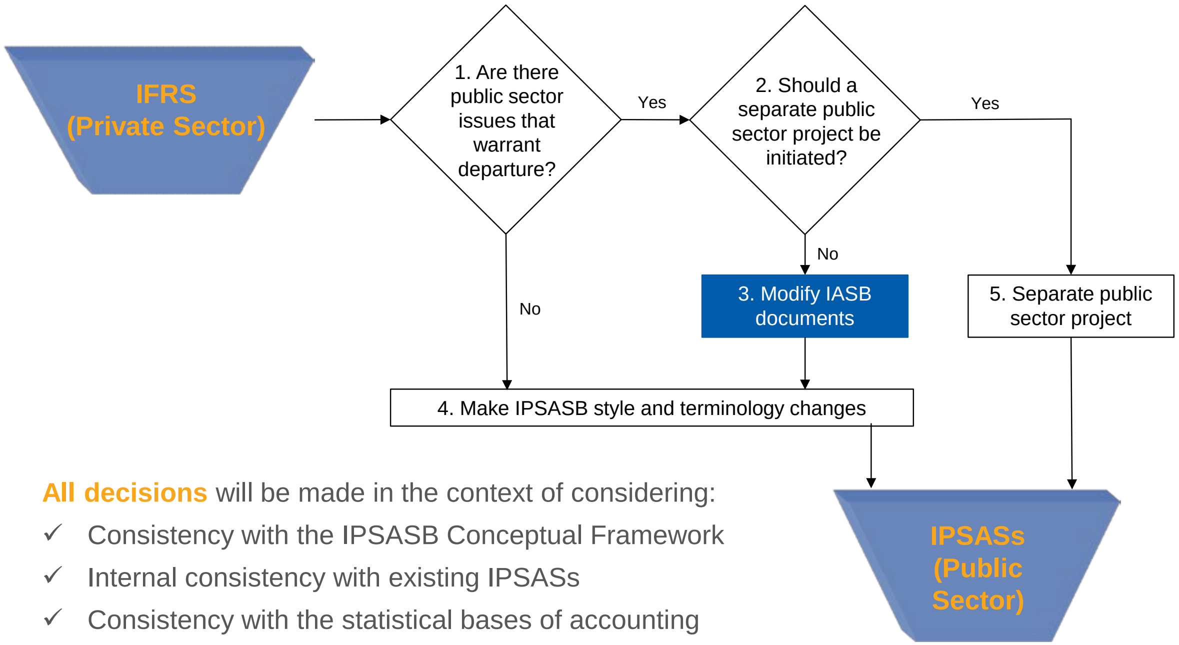
Lessee accounting in ED 64 is converged with IFRS 16.

"*Rules of the Road*"

The IPSASB is of the view that the economics of a lease transaction were the same in both the public and private sector. Consequently, when developing its Leases project, the IPSASB followed the decision tree below as set out in the "*Rules of the Road*".

Lessee accounting in IFRS 16

When applying the "*Rules of the Road*", the IPSASB considered that there were no public sector issues that warranted departure from the new lease accounting model for lessees in IFRS 16—the right-of-use model. Consequently, ED 64 proposes the right-of-use model for lessees converged with IFRS 16.



All decisions will be made in the context of considering:

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

Development of ED 64—Lessor accounting

Convergence with IFRS 16 for lessor accounting would give rise to a number of public sector specific issues.

ED 64 proposes the right-of-use model also for lessors to address public sector specific issues, while ensuring consistency with IPSASB's literature and lessee accounting.

Departure from IFRS 16 lessor accounting

For lessors, IFRS 16 retained the risks and rewards incidental to ownership model in IAS 17 (reflected in IPSAS 13). When the lessor and the lessee are public sector entities in the same lease contract, the lack of consistency between lessor and lessee accounting in IFRS 16 leads to:

(a) The underlying asset not being recognized by the lessor nor by the lessee if the lessor classifies the lease as a finance lease; and

(b) The lessor not recognizing a lease receivable if the lease is classified as an operating lease, while the lessee always recognizes a lease liability.

The above situations could give rise to a number of practical issues that are more prevalent in the public sector:

(a) Consolidation issues where the lessor and lessee are part of the same economic entity and separate records needs to be maintained for the underlying asset and lease receivable;

(b) Understandability issues because of different accounting models for the same transaction—it may be difficult for users to distinguish between a lease and the sale of an asset in lessor's financial statements.

(c) Asymmetrical information in the public sector—different recognition criteria for the same transaction distorts the analysis of the financial position of public sector entities.

The IPSASB concluded that:

(a) The risks and rewards incidental to ownership model is inconsistent with:

  (i) *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework)*; and

  (ii) Control-based approach in other IPSAS, for example IPSAS 32, *Service Concession Arrangements: Grantor.*

(b) The lessor should not derecognize the underlying asset because in a lease the lessor is transferring the right to use an underlying asset to the lessee, not the underlying asset itself.

(c) The lease receivable meets the definition of an asset and should always be recognized.

As a consequence, the IPSASB decided to depart from IFRS 16 for lessor accounting and propose a single right-of-use model for lessors specifically designed for public sector financial reporting.

What is the right-of-use model in lease accounting?

The right-of-use model is based on the principle that lease contracts simultaneously create, transfer and finance a right to use an underlying asset.

Characteristics of the right-of-use model

ED 64 proposes a single model for lease accounting based on the principle that lease contracts simultaneously:

(a) Create an asset (the right-of-use asset) separate from the underlying asset;

(b) Transfer the right to use an underlying asset (the right-of-use asset) from the lessor to the lessee, not the underlying asset itself; and

(c) Finance the right to use an underlying asset.

Under the right-of-use model, a lease is, in substance, a sale of an unrecognized right-of-use asset, for which the lessor has a performance obligation to provide access to the underlying asset to the lessee, in exchange for cash.

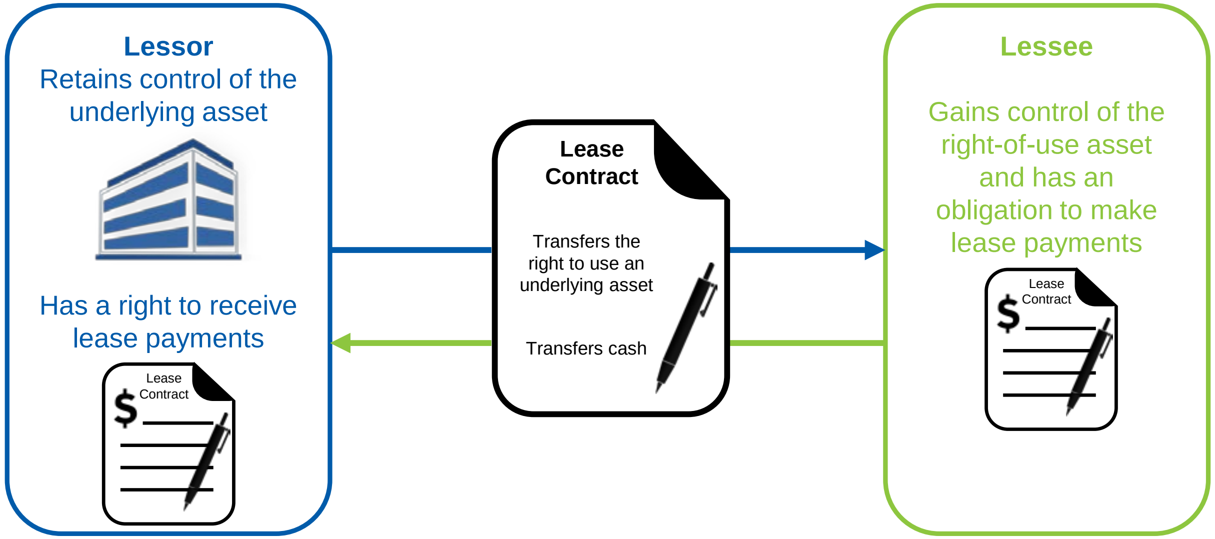
Control of the underlying asset versus control of the right-of-use asset

The right-of-use model distinguishes the:

(a) Underlying asset from the right-of-use asset as separate economic phenomena; and

(b) Control of the underlying asset held by the lessor from the control of the right-of-use asset held by the lessee.

ED 64 provides guidance on how to account for the underlying asset, the lease in the lessor's accounts (the sale of the right-of-use asset) and the lease in the lessee's accounts (the purchase of the right-of-use asset).



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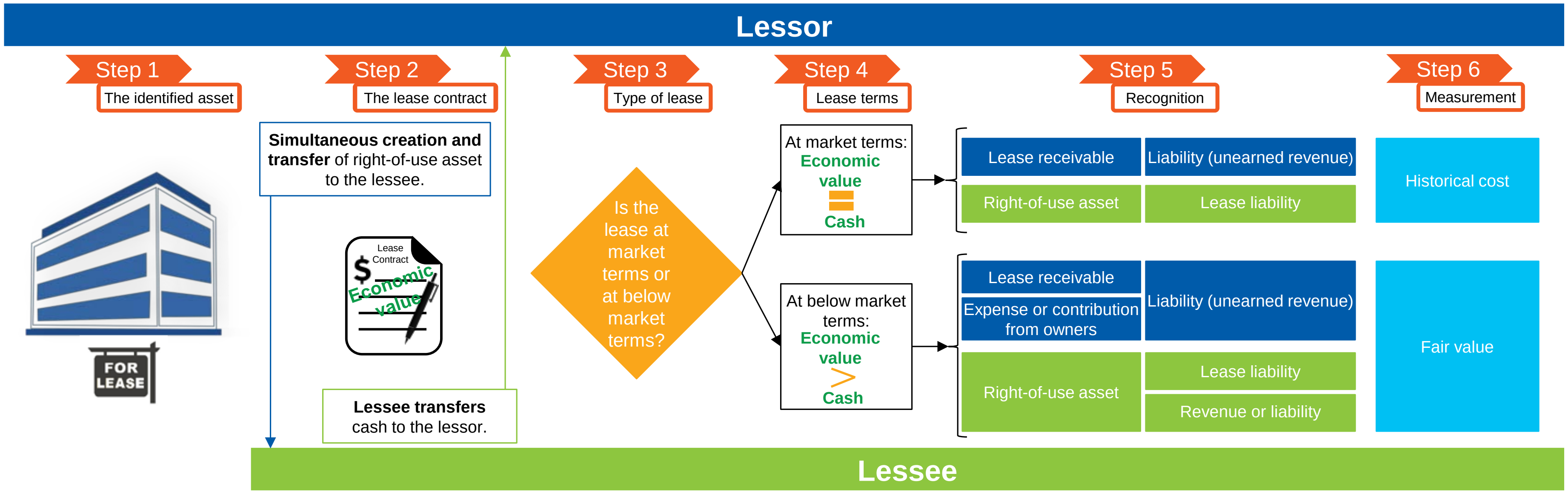
What is the right-of-use model in lease accounting?

IPSASB right-of-use model in six steps



What changes in lease accounting?

ED 64 proposes to retain substantially the definition of a lease in IPSAS 13, but to change the guidance on how to apply it.

Definition of a lease

The definition of a lease in ED 64 is applicable to both parties of a lease contract, i.e. the supplier ('the lessor') and the customer ('the lessee').

ED 64 proposes determining whether a contract contains a lease on the basis of whether the customer has the right to control the use of an identified asset for a period of time.

Lease versus service concession arrangement versus service

The new guidance on identifying a lease may exclude from the scope of ED 64 certain arrangements that may have been considered within the scope of IPSAS 13:

(a) Service concession arrangements within the scope of IPSAS 32, *Service Concession Arrangements: Grantor* (for example, some contracts to use an identified asset); and

(b) Service contracts (for example, some supply contracts).

Type of control / Classification	Lease	Service concession arrangement	Service
Control of an identified asset	Lessor: Yes Lessee: No	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to use an identified asset	Lessor: No Lessee: Yes	Grantor: Yes Operator: No	Supplier: Yes Customer: No
Control of the right to access to operate an identified asset	Lessor: No Lessee: Yes	Grantor: No Operator: Yes	Supplier: Yes Customer: No

What changes in lease accounting?

In IPSAS 13, the focus is on the underlying asset—who recognizes the underlying asset?

In ED 64, the focus is on the right-of-use asset—how to account for the sale and purchase of the right-of-use asset by lessors and lessees, respectively?

Risks and rewards incidental to ownership versus control of the underlying asset

In IPSAS 13, the focus is on the underlying asset—the underlying asset is recognized by lessors or lessees depending on who has substantially all the risks and rewards incidental to ownership of an asset.

On the contrary, in the right-of-use model proposed in ED 64 the focus is on the accounting for the new resource created by the lease contract—the right-of-use asset.

This means that lessors account for the underlying asset separately from the sale of the right-of-use asset created by the lease contract because the IPSASB is of the view that both are separate economic phenomena. The proposed guidance is consistent with the grant of a right to the operator model with existing assets in IPSAS 32, *Service Concession Arrangements: Grantor*, where the grantor sells a right to access to operate an identified asset to the operator (the other party to the transaction).

On the other hand, lessees account for the purchase of the right-of-use asset, not the purchase of the underlying asset itself. The proposed guidance is consistent with IFRS 16, *Leases*.

Concessionary leases

ED 64 proposes new public sector specific requirements to account for concessionary leases for both lessors and lessees based on the right-of-use model.

The proposed guidance for accounting for the subsidy is consistent with IPSASB literature on accounting for non-exchange transactions and concessionary loans.

The IPSASB is of the view that the nature of the resource transferred does not affect the economic substance of a subsidy. Consequently, whether an entity grants a loan or transfers a right-of-use asset at below market terms the accounting for the subsidy should be the same.

What changes in lessor accounting?

ED 64 proposes the right-of-use model for lessors by distinguishing the retention of control of the underlying asset by the lessor from the transfer of control of the right-of-use asset to the lessee.

Recognition and measurement of leases at market terms—General guidance

ED 64 proposes to change significantly how a lessor accounts for leases (except for short-term leases) applying IPSAS 13.

ED 64 proposes:

(a) Continuing to recognize the underlying asset in the lessor's accounts because the lessor continues to control the underlying asset in a lease. In IPSAS 13 the underlying asset is derecognized if the lessor classifies the lease as finance lease;

(b) Recognizing a liability (unearned revenue) because the lessor sells an unrecognized right-of-use asset to the lessee and has a present obligation to provide access to the underlying asset to the lessee. In IPSAS 13 the lessor does not recognize a liability (unearned revenue).

(c) Recognizing a lease receivable because the lessor gains control of the right to receive lease payments from the lessee. In IPSAS 13 the lease receivable is not recognized if the lessor classifies the lease as operating lease.

ED 64 proposes measuring the:

a) Underlying asset according to the applicable IPSAS in order to ensure consistency with IPSASB's literature;

b) Lease receivable initially at the present value of the future lease payments because it is consistent with the approach used to measure other similar assets (e.g. loans in IPSAS 29, *Financial Instruments: Recognition and Measurement*); and

c) Liability (unearned revenue) initially at the initial value of the lease receivable, plus the amount of any lease payments received at or before the commencement date of the lease that relate to future periods because it is consistent with the approach used to measure other similar liabilities (e.g. the grant of a right to the operator model with existing assets in IPSAS 32, *Service Concession Arrangements: Grantor*).

Recognition exemption

IPSAS 13 does not have any recognition exemption for lessors. ED 64 proposes to introduce a recognition exemption for short-term leases—leases of 12 months or less.

ED 64 proposes to account for short-term leases in the same way as operating leases under IPSAS 13—as revenue on a straight-line basis over the lease term or another systematic basis.

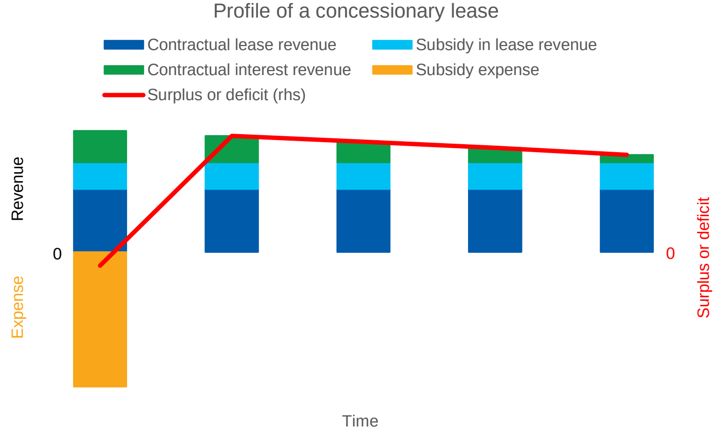
Lessor—Accounting for the subsidy in concessionary leases

ED 64 proposes to account for the subsidy in concessionary leases in the same way as in concessionary loans.

Recognition and measurement

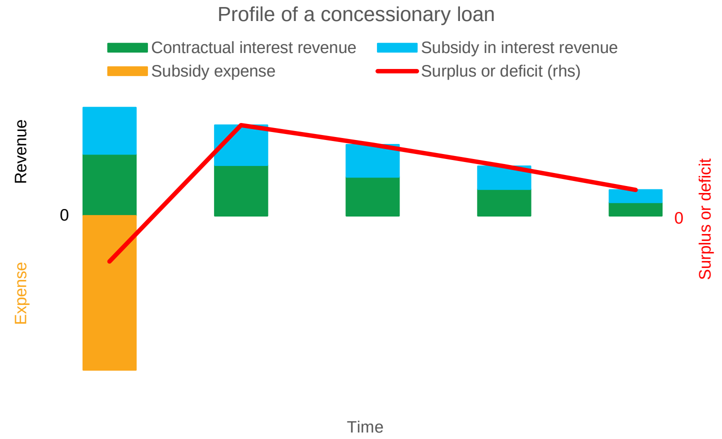
Liability (unearned revenue)

ED 64 proposes measuring the liability (unearned revenue) in a concessionary lease at fair value by discounting market lease payments using a market interest rate. The liability (unearned revenue) represents the full economic value of the resource created (the right-of-use asset) and transferred to the lessee, which is higher than the future cash inflows (contractual lease payments).



Subsidy as expense on day-one

Consistent with the accounting treatment of concessionary loans in IPSAS 29, *Financial Instruments: Recognition and Measurement*, ED 64 proposes recognizing the subsidy granted to lessees as a day-one expense, except if it is a contribution from owners. The IPSASB is of the view that recognizing the subsidy as a day-one expense provides the most useful information for accountability purposes because it shows the cost of the decision to grant the concession.



Subsidy as revenue over the lease term

As leases result in transferring an unrecognized right-of-use asset to the lessee and loans result in transferring recognized cash to the borrower, the initial credit entry in leases is a liability (unearned revenue) and in loans is the derecognition of cash. As the lessor has a present obligation to provide access to the lessee to the underlying asset regardless of the amount of cash being transferred, which prevents the lessor recognizing revenue on day one, the liability (unearned revenue) also includes the subsidy. Consistent with concessionary loans, subsequently the subsidy will also be recognized as revenue over the lease term together with the cash component of the lease.

What changes in lessee accounting?

ED 64 proposes the right-of-use model for lessees, which distinguishes the right to use an underlying asset (which the lessee controls) and the underlying asset itself (which the lessee does not control).

Recognition and measurement of leases at market terms—General guidance

ED 64 proposes to change significantly how a lessee accounts for leases (except for short-term leases and leases of low-value assets) applying IPSAS 13.

ED 64 proposes recognizing:

(a) A right-of-use asset because the lessee controls the right to use the underlying asset. In IPSAS 13 the lessee recognizes the underlying asset in a finance lease, but not in an operating lease.

(b) A lease liability because the lessee has a present obligation to make lease payments that arises from the lease contract (once the underlying asset has been available to the lessee), which results in future outflows of economic benefits from the lessee. In IPSAS 13 the lease liability is not recognized if the lessee classifies the lease as operating lease.

ED 64 proposes measuring the right-of-use asset and the lease liability at cost by reference to the present value of the lease payments because it is consistent with the approach to measure other similar assets in IPSAS.

Recognition exemptions

IPSAS 13 does not have recognition exemptions for lessees. ED 64 proposes two recognition exemptions for:

(a) Short-term leases; and

(b) Leases for which the underlying asset is of low value.

ED 64 proposes accounting for leases under recognition exemptions in the same way as operating leases under IPSAS 13: as expense on a straight-line basis over the lease term or another systematic basis.

Lessee—Accounting for the subsidy in concessionary leases

ED 64 proposes to measure concessionary leases at fair value and recognize revenue in accordance with IPSAS 23.

Recognition and Measurement

For lessees, ED 64 proposes that concessionary leases should be measured at fair value because it avoids an understatement of the right-of-use asset and recognizes the subsidy received by the lessee.

Right-of-use asset

ED 64 proposes that the right-of-use asset in a concessionary lease should be measured at fair value by discounting market lease payments using a market interest rate in order to determine the fair value of the purchase of the right-of-use asset. This is consistent with requirements in the IPSASB literature on the measurement of assets resulting from non-exchange transactions.

Subsidy as revenue or liability on day one

ED 64 also proposes recognizing the subsidy in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* as revenue on day one, except if a present obligation exists, e.g., where specific conditions imposed on the transferred asset (the right-of-use asset) by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.

This approach to revenue recognition in concessionary leases is also consistent with the approach in concessionary loans.

Sale and leaseback transactions

ED 64 proposes to recognize right-of-use assets and its related lease liabilities for all sale and leaseback transactions.

ED 64 also proposes to account for concessionary leasebacks in accordance with the guidance for concessionary leases.

Less incentive for off balance sheet accounting and improved comparability of financial information

When applying IPSAS 13, an entity has an incentive for selling the assets that it owns and lease those assets back through operating leases because it would report less assets and less financial debt—thus improving its financial indicators. However, in substance the entity was neither changing its operations nor the use of the assets that it leased back.

ED 64 proposes recognizing the rights to use those same assets and related liabilities for all sale and leaseback transactions and restricts the amount of any gain recognized on the sale of an asset.

As a result, the proposals in ED 64 provide less incentive for entities to enter into sale and leaseback transactions and more comparability of financial information reported in the statement of financial position between entities that lease assets and entities that buy assets.

Accounting for concessionary leasebacks in the same way as in concessionary leases

ED 64 proposes accounting for the subsidy in a concessionary leaseback consistent with concessionary leases. IFRS 16 accounts for the subsidy component in a concessionary leaseback as a prepayment of lease payments.

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Next Steps:

The deadline for comments is June 30, 2018.

During the comment period, the IPSASB members are available to discuss the proposals with a wide range of parties.

How can I comment on the proposals?

ED 64 requests comments on four Specific Matters for Comment (SMC) as follows:

(a) Proposal of the IFRS 16 right-of-use model for lessee accounting (SMC 1);

(b) Proposal to depart from the IFRS 16 risks and rewards model for lessor accounting (SMC 2);

(c) Proposal of a single right-of-use model for lessor accounting consistent with lessee accounting (SMC 3); and

(d) Proposal to account for the subsidy in concessionary leases in the same way as in concessionary loans (SMC 4).

Respondents are also welcome to comment on any other matter they think the IPSASB should consider in forming its views.

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF file and a Word file.

Comment letters will be posted on the IPSASB website.

The IPSASB will carefully consider all feedback and discuss responses at its public meetings after the comment period has ended.

Stay informed

The IPSASB's website will indicate the meetings at which feedback on the ED will be discussed. The dates and the locations of 2018 meetings are available at:

http://www.ipsasb.org/meetings

To stay up to date about the project, please visit:

http://www.ipsasb.org/projects/leases